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Issues in Federal, State, and Tribal Taxation of Reservation Wealth: A Survey and Economic Critique

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ISSUES IN FEDERAL, STATE, AND TRIBAL TAXATION OF RESERVATION WEALTH: A SURVEY AND ECONOMIC CRITIQUE

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I. INTRODUCTION

Taxation has become one of the most controversial issues in Indian affairs. As tribes take advantage of federal economic development programs and as reservations' reserves of natural resources become increasingly more valuable, there is more on Indian reservations to tax.[1] The federal government appears anxious for tribes to assume a greater share of the administrative responsibility and cost of reservation services.[2] Tribal economic development has increased reservations' taxable wealth, but the base is still small relative to tribal revenue requirements because needs are so great and because growth has attracted immigration.[3] At the same time state and local revenue systems are under increasing strain. The net effect of reservation economic development, of growing demands for state, local, and tribal services, and of increasing difficulty in raising local revenues is intensified competition for reservation tax base and more pressure on the courts to resolve long-standing ambiguities in the law of reservation taxation.

Unfortunately, Indian tax law evolved willy-nilly into a tangle which is equally aggravating to tribal, state, and federal tax collectors. Judicial misuse of economics has been a major factor. Judicial analysis of economic transactions tends to be formalistic and preoccupied with semantics and taxonomy.[4] As a result, the practical effects of decisions are often at cross-purposes with judges' intentions. This article

1. *See generally* ECONOMIC DEVELOPMENT ADMINISTRATION, U.S. DEP'T OF COMMERCE, INDIAN PROJECTS FUNDED BY THE EDA (1977); STAFF OF AMERICAN INDIAN POLICY REVIEW COMM'N, REPORT ON RESERVATION AND RESOURCE DEVELOPMENT AND PROTECTION 87–121, 149–67 (Comm. Print 1976); Ruffing, *Navajo Mineral Development,* 11 INDIAN HISTORIAN no. 2, at 28 (1978); Schusky, *Development by Grantsmanship: Economic Planning on the Lower Brule Sioux Reservation,* 34 HUMAN ORGANIZATION 227 (1975).

2. *See* Barsh & Trosper, *Title I of the Indian Self-Determination and Education Assistance Act of 1975,* 3 AM. INDIAN L. REV. 261 (1975) (discussing one attempt at returning governing power to tribes).

3. It is difficult to verify tribal officers' reports of recent net reservation in-migration because only the 1950 and 1970 censuses enumerated population by reservations, and even then only for larger reservations. It is possible, however, to estimate reservation population changes from county data. In South Dakota, for example, the population of counties located entirely within reservations increased 5.8% between 1960 and 1970, while the overall population of the state declined 2.2%. Compiled from BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION: SOUTH DAKOTA 43–14 to 43–25 (1973).

4. *See* R. Barsh, The Washington Fishing Rights Controversy: An Economic Critique 1, 43–57 (Graduate School of Business Administration, University of Washington, Monograph Series 1977).

will consider the most important Indian tax decisions, comparing the intended results of the decisions in the context of congressional Indian law with their probable economic consequences. Part II briefly reviews the main factors essential for proper economic evaluation of a tax. Part III critically surveys recent law of federal taxation of reservation wealth. Part IV similarly surveys and criticizes decisions regarding state taxation of reservation wealth. Part V offers alternate resolutions for state-Indian taxation disputes. In Part VI, the article proposes a framework for applying tax economics productively to the problem of meeting tribal revenue needs.

II. PRINCIPLES OF TAX EVALUATION

A. The Forms and Functions of Taxation

We usually think of a tax as a bill for public works and services. To an economist, however, a "tax" is anything done by government that increases the cost of transactions.[5] A tax in this more general sense may be difficult to identify and measure. For example, public regulation of business in the form of limitations, restrictions, conditions, and requirements of disclosure and filing tends to make regulated activities more costly. Businesses pay part of this regulatory tax in the form of higher material or production costs needed to meet government standards. Part of the tax may also be paid to lawyers, accountants, consultants, bureaucrats, and other people businesses must deal with to comply with the regulations. We hope that the tax will also benefit the people our legislators intended to aid by the regulation in the first place. Thus, while we are most familiar with explicit taxes which involve a direct payment of money, other kinds of taxes are created by public action that results in changes in citizens' relative wealth.

Taxation may serve four major functions: (1) revenue-raising, (2) regulation, (3) redistribution, and (4) fiscal stabilization. A tax may be used to raise funds to pay for public services. Even in a market economy there are important goods and services individual citizens simply cannot buy for themselves.[6] In such cases, the only alternative to pub-

5. *See generally* Posner, *Taxation by Regulation,* 2 BELL J. ECON. & MANAGEMENT SCI. 22 (1971).

6. National defense is an extreme case, and accordingly the one most often called upon by economists to make this point. There are many less obvious but equally important examples of public goods. Roads and bridges and other major public works are very costly, require comprehensive planning, and do not pay for themselves for many years.

lic operation is operation by a private monopoly which can coordinate all related activities and charge everyone in society for the use of its services.[7] Out of self-interest, however, a private monopoly may charge too much for its services or, without fear of competition, provide them badly. Evaluation of revenue taxation therefore always entails four questions: Does the tax support an activity that cannot be provided efficiently by competitive private enterprise? Who benefits from the activity and should therefore pay for it? Should the beneficiaries pay at rates reflecting differences in consumption? Which kind of tax generates the greatest net yield?

Another function of taxation is regulation. We often use variable taxes to change the way people behave.[8] Taxing an activity harder discourages it; giving the activity a relative tax break encourages it. The practical effectiveness of a regulatory tax depends on several factors. The activity to be changed must be precisely identified. Collected from the wrong taxpayers, the tax will be ineffective and may have unintended side effects.[9] A regulatory tax also will be ineffective unless it is levied in such a way that taxpayers have an opportunity to avoid it, or, in the case of a tax subsidy, to take advantage of it. A retroactive tax cannot change behavior. An ambiguous or uncertain tax likewise is less effective in influencing behavior. Although differences in personal preferences mean that a regulatory tax will be more or less effective on different people,[10] we generally tax classes of people at the same rate. While this is relatively inexpensive to administer, it results only in an average reduction in the incidence of the taxed activity.

A third function of taxation is redistributing income. Many of us

7. If goods such as education, public health, or national defense were provided for through private markets, without coercive power to make all contribute, some beneficiaries would inevitably get a free ride.

8. Rather than to think of taxes as analogous to the positive commands of law, it may be more useful to think of the positive commands of law as taxes. If you violate a proscriptive law, something unpleasant is done to you. Often this is a requirement that you pay the government some money. This taxes your activity. More specificially, the tax on the activity is equal to the average penalty discounted by the probability you will be discovered and forced to pay it. *See* H. PACKER, THE LIMITS OF THE CRIMINAL SANCTION 277–82 (1968); G. TULLOCK, THE LOGIC OF THE LAW 211–27 (1971).

9. When it is difficult to isolate the target activity, some more easily identified antecedent or subsequent activity may be taxed instead. In such cases the effectiveness of the tax is also a function of the correlation between the target activity and the activity taxed.

10. People who place a higher value on an activity will bear a higher tax before giving it up. To reduce everyone's participation in the taxed activity by an equal amount a regulatory tax would have to tax each person at a different rate, based on the value of the taxed activity for that person.

value the experience of participating in a society in which all citizens enjoy a minimum standard of living. We are willing to pay for this experience by imposing a tax cost on ourselves to support redistributive programs. These taxes are not limited to people who believe in income redistribution, however. In principle we allocate them most heavily to the "deepest pocket." Public sentiment, as well as considerations of revenue maximization and administrative efficiency, support taxing the rich because they are rich. The expenditure of tax proceeds is as important as the character of the tax collected in determining tax effects.[11] A proportional income tax invested entirely in benefits serving one sector of society can be highly redistributive, while a progressive income tax schedule can be rendered proportional in net effect if tax-financed benefits are proportional to taxes paid.[12]

The fourth kind of tax function is fiscal stabilization.[13] Fiscal stabilization is the process of evening out fluctuations in unemployment and output. Some taxes have an automatic stabilizing effect. General taxes on net income or consumption expand and contract with aggregate social output. Public expenditures and reductions in general income and consumption tax rates tend to stimulate output, while curtailing expenditures or increasing tax rates have the opposite effect. Combined with control of the money supply, power to tax and spend enables government to affect the level of prices and unemployment without direct selective regulation.

A tax may be regulatory, redistributive, stabilizing, or for the purpose of financing public goods. In pure form, revenue taxes are allocated on the basis of benefit to be received from expenditure of tax funds, regulatory taxes according to the activities they are designed to modify, and redistributive taxes in an inverse function of wealth. It is impossible, however, to treat any real-world tax as being of only one or another type. Deliberately or unwittingly, we mix the functions of taxes. Our federal income tax is a perfect example of a tax that intentionally serves all four tax functions. A deduction is never simply a regulatory subsidy. Its enforcement affects the aggregate yield of the

11. *See generally* Gillespie, *Effect of Public Expenditures on the Distribution of Income*, in ESSAYS IN FISCAL FEDERALISM 122 (R. Musgrave ed. 1965).

12. Similar phenomena occur for the other functions of taxation. For example, our current national policy specially taxes tobacco producers by means of excise taxes and marketing restrictions on an activity-reducing theory, while simultaneously diverting national tax revenues to support tobacco prices on an activity-increasing basis. The net effect is important.

13. *See generally* R. MUSGRAVE & P. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 535–66 (1973); J. PECHMAN, FEDERAL TAX POLICY 10–14 (3d ed. 1971).

tax and therefore both the level of public services and the redistribution of income. Rational construction of a tax code involves numerous trade-offs among goals.

B. The Economic Incidence of Taxation

Taxpayers are often able to shift all or part of their tax burden to others in the course of private transactions. How much shifting occurs and, accordingly, how much of the tax burden each taxpayer really bears depends on the kinds of transactions taxpayers engage in with one another, not the way in which taxes are collected or upon whom the legal liability falls. This is the part of tax evaluation which courts most often seem to miss.[14]

1. Taxes on consumption

Recent litigation of state taxation of reservations often involves taxes on consumption.[15] A tax on consumer goods[16] may be collected while the goods are in the hands of the manufacturer, as in the case of federal liquor taxes; or when they are delivered to a wholesaler, as is done with cigarettes; or as a surcharge on the price of the goods paid by consumers to retailers, such as a conventional "sales" tax; or as a tax payable by the consumer some time after purchase of the goods, which is referred to as a "use" or "property" tax. It is possible to collect a tax on consumption at any point in the chain of distribution, from raw material to garbage heap.

Tax administrators naturally prefer to levy taxes where the taxed goods are in the hands of relatively few people, where they are in the hands of people who can pay the tax in cash at once, or where the

14. *See, e.g.*, Moe v. Confederated Salish & Kootenai Tribes, 425 U.S. 463, 481-82 (1976).

15. *See, e.g.*, Moe v. Confederated Salish & Kootenai Tribes, 425 U.S. 463 (1976) (cigarette tax); Muckleshoot Indian Tribe v. Washington, No. C78-783V (W.D. Wash. Mar. 8, 1979) (order granting plaintiff's motion for summary judgment) (liquor sales regulation and taxation); Confederated Tribes of Colville Indian Reservation v. Washington, 446 F. Supp. 1339 (E.D. Wash. 1978) (three-judge court) (cigarette tax and general sales tax), *appeal docketed*, No. 78-630 (S. Ct. Oct. 13, 1978), *consideration of jurisdiction postponed to hearing on merits*, 99 S. Ct. 1210 (1979).

16. For the purpose of incidence analysis it makes little difference under competitive conditions whether these taxes are collected as a flat unit markup or as an ad valorem (percentage) markup. R. MUSGRAVE & P. MUSGRAVE, *supra* note 13, at 431.

goods can be simply and conveniently counted.[17] This reduces the total cost of collecting the tax and therefore increases its net yield. The point of enforcement cannot affect the ultimate distribution of the burden of the tax, however. Suppose a tax is levied on wholesalers. Wholesalers may shift all or a part of this cost to retailers by raising wholesale prices. Retailers in turn may shift all or a part of increased wholesale prices to consumers by raising retail prices. Or wholesalers may respond by paying less to suppliers, by decelerating wage increases for employees, by paying reduced dividends to stockholders, or by some combination of these means. The owners and employees of each firm in the chain of distribution are also themselves consumers of the taxed product. A process of adjustment will occur at every step in the chain of distribution backwards and forwards from the point of enforcement. Figure 1 illustrates the systems relationship among taxables.

How much of a particular tax on goods will be shifted by the initial taxpayer depends in the first instance on the tax's selectivity. Selective consumption taxes are usually called "excise" taxes.[18] Since consumers can avoid a selective tax by purchasing untaxed goods, sellers have an incentive to absorb the tax. Moreover, if consumers avoid a selective tax on *A* by buying less *A* and more *B*, the increased demand for *B* increases its price. This forces consumers of untaxed goods to bear a part of the burden of selective taxes.[19] The proportion of tax that is shifted by consumers to sellers or that sellers cannot shift to consumers is a function of the "price elasticity of demand," or responsiveness of consumer behavior to price changes. Demand for a good is said to

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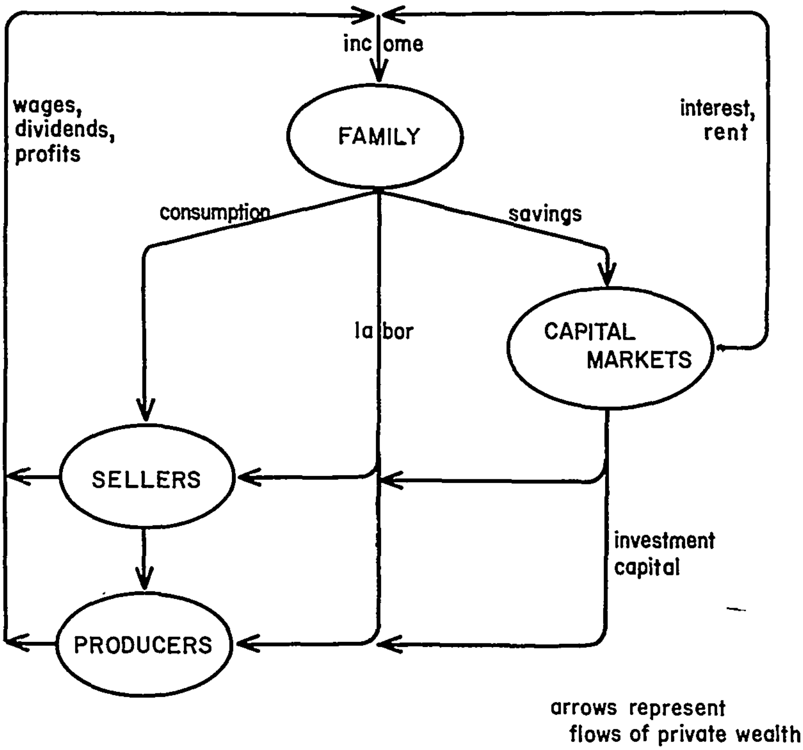
17. Small jurisdictions will choose to levy taxes on those phases of production which predominate within their borders. This is a revenue-maximizing strategy. A state where paper is manufactured prefers to tax gross output rather than retail sales of paper. This can be a problem for a multistate enterprise, as each state will try to tax the whole firm through its in-state subsidiaries. *Id.* at 306.

18. "Excise" taxes are usually thought of as taxes on particular goods, such as motor vehicles and fuels, liquor, and tobacco products. Years ago these excises were popularly called "luxury taxes" because they were often justified as falling only on unnecessary expenditures. They did not, it was supposed, hurt anyone's ability to secure the basics of life. Today some are described as "vice" or "demerit" taxes in the belief that they help limit the frequency of mildly undesirable activities.

19. Firms may price on other than revenue-maximizing criteria. R. MUSGRAVE & P. MUSGRAVE, *supra* note 13, at 404–05. Some examples are markup pricing, breakeven or investment-recovery pricing, pricing in accordance with fixed rate-of-return goals, and pricing to maximize gross sales. In such cases the tax may be shifted to consumers with little or no effect on volume up to the point that the after-tax price exceeds demand. *See also id.* at 423–32; J. PECHMAN & B. OKNER, WHO BEARS THE TAX BURDEN? 35 (1974) (effect on corporate income tax incidence if firms do not operate on profit-maximizing assumption).

FIGURE 1
THE INTERRELATIONSHIP OF FACTORS OF PRODUCTION



be relatively price inelastic if changes in price result in relatively small changes in consumption.[20] Price elasticity varies with the price of the good and can be determined only by observation of consumer behavior.

Consumers' share of a selective consumption tax is proportional to the price inelasticity of demand. Sellers can shift a tax to consumers by raising prices only to the extent that consumers will not give up the taxed goods.[21] When the tax is levied initially on consumers, sellers can avoid lowering the price and thus sharing part of the tax only to

20. Demand is "infinitely" elastic if there is only one price, and any change results in zero consumption; similarly, demand is "perfectly inelastic" when consumption is unaffected by price.

21. If consumers are willing to give up the taxed good, the seller will have to absorb part of the tax himself by increasing price in an amount less than the tax. Tax-sharing between sellers and consumers also depends on the price elasticity of supply, which is

the same extent. In either case, it is irrelevant whether the tax is first levied on sellers or consumers.[22] Excise taxes on motor fuels, liquor, and tobacco are popular among tax administrators because of the price inelasticity of demand for the taxed goods; the tax base is relatively unaffected by imposition of the tax. Any selective tax nevertheless affects consumption and discourages investment in the production and distribution of the taxed good. Capital and labor move from the taxed sector to untaxed sectors, lowering factor costs and prices. Therefore, a part of the tax burden is imposed on untaxed industries. The overall effect is to distort the free market allocation of resources and the mix of consumption that maximizes consumer utility. The cost of this distortion is often described as "excess burden" because it is in excess of tax costs converted to public revenue. Tax burdens slice the national output pie differently between public and private sectors. Excess burdens reduce pie size.

2. *Property taxes*

Property taxes are of two kinds: periodic taxes on consumer goods and taxes on capital. A tax on housing is a periodic tax on a consumer good, housing services, collected in annual installments. Homeowners, of course, bear this tax and cannot shift it to another. But because demand for rental housing is usually relatively price inelastic, most of a tax on rental owners probably is shifted to tenants. To the extent that a tax on housing is borne by owners of rental property, investment in the construction and maintenance of housing is discouraged and capital flows to other investment sectors, reducing housing stock and thereby raising the average rent.

Owners of productive property can avoid tax only by reinvesting in an untaxed sector. However, they can sell their taxed property and reinvest elsewhere only after the tax has reduced their property's net worth.[23] In the short run, owners of productive property therefore

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the relationship of supply to price. In the exceptional case where producers' output remains unchanged regardless of market conditions (perfectly inelastic supply), it is a buyer's market and consumers bear none of any tax on the goods. Typically, however, supply is elastic, just as is demand. The more elastic supply, the greater the seller's ability to shift taxes forward to consumers. R. MUSGRAVE & MUSGRAVE, *supra* note 13, at 433–34.

22. It is also irrelevant for this purpose whether the tax is levied as a single tax or as a series of stage-by-stage value-added taxes. *Id.* at 306, 423.

23. Owners of buildings may permit them to deteriorate, using up their depreciable value, rather than selling. This helps explain the proliferation of urban "slumlording" under rising property tax rates.

bear the full tax.[24] In the long run, investment in property is discouraged. Investment in other sectors increases, increasing the supply of capital and decreasing the return on investment in those sectors. In this way the tax is shared by all owners of capital.

American property taxes are selective in that they apply to some forms of productive wealth but not to others. Real capital such as land, plants, and machinery is taxed, while securities, commercial paper, demand deposits, intangibles like copyrights, and cash are exempt. A truly general wealth tax would preserve the efficient allocation of productive factors to industries. Our selective property tax distorts the allocation of factors by favoring industries in which the ratio of real capital to other factors is low. In an industry where machinery is more efficient than labor, for example, a property tax on machinery will encourage the substitution of labor. This is the excess burden of the tax.

3. *Income taxes*

Income taxes bear a very close relationship to property taxes. While sales taxes are levied on consumption, both income and property taxes fall on the factors of production. A property tax applies to the net value of the factor measured by its market price; an income tax to the net value of the income of the factor (labor or capital) measured by wages, interest, dividends, and profits. Like property taxes, income taxes tend to be borne by owners of the taxed factors. A general net income tax would reduce the yield of all factors proportionally and therefore have no significant reallocative effect. However, capital gains are taxed at a discriminatorily low rate. Corporate income is taxed twice, first as earnings and then as dividends. In the long run capital is completely mobile, so these exceptions should result in reallocation.

Whether an income tax on business can be shifted to labor, or a tax on wages shifted to business, are much-debated questions, complicated by inconsistent empirical studies and differing assumptions about the nature of the labor supply.[25] Some tax on business

24. It is assumed that business cannot shift the property tax to consumers. Shifting is unlikely because property taxes vary greatly among localities. If businesses in high-tax localities tried to shift by raising prices they would lose sales to businesses in low-tax localities.

25. *See, e.g.*, R. MUSGRAVE & P. MUSGRAVE, *supra* note 13, at 382–90, 396–411; J. PECHMAN & B. OKNER, *supra* note 19, at 30, 34–35. If we assume that wages are maximized relative to the net earnings of the firm prior to the imposition of the tax, employees' ability to shift the burden to their employers depends on their employers' ability to shift

may be shifted to labor because the labor supply is both relatively fixed and relatively non-mobile. If employees are unable or unwilling to avoid tax shifting by going to work elsewhere, they will bear a part of any increase in business taxes.

American income taxes are nominally progressive. Whether they are to be considered progressive in fact depends upon many assumptions, especially regarding employers' ability to shift taxes to employees. Interestingly, however, regressive state and local consumption taxes probably offset any progressivity of the income tax completely, so that the effective burden of all taxes appears in fact to be proportional across income brackets.[26]

Familiar taxes and their predicted incidence are summarized in Figure 2. It is important to recognize the relative meaninglessness of legal labels. The name of a tax or its initial payer are irrelevant. What the tax does *is* relevant and is a function of the economic nature of the tax, its actual incidence, as determined by general prediction and specific measurement, and, always, the economic structure of the taxing jurisdiction.

C. *Problems and Goals of Intergovernmental Tax Policy*

It is difficult enough to coordinate different taxes within a single taxing jurisdiction so that in combination they synergize rather than undo one another's objectives. It is much more difficult to plan taxes in an environment of neighboring and overlapping taxing jurisdictions. When more than one jurisdiction taxes the same transactions, or some tax and others exempt, none can fully accomplish their goals. A simple revenue tax will serve as an example of the problems of multiple taxation. Increasing the rate of the tax discourages the taxed activity, so that at some point higher rates result in lower yields. If jurisdiction *A* is already taxing at the yield-maximizing rate when jurisdiction *B* begins to tax, jurisdiction *A* cannot protect its revenue by imposing a retaliatory tax rate increase. The rate increase would actually reduce the aggregate yield of both taxes. Or suppose that jurisdiction *A* is willing to trade away some revenue for gains in the rate of growth and therefore selects a tax rate below the yield-maximizing

in turn to consumers (who, of course, include the employees). Wages may be "administered," that is, fixed by regulated union-management negotiations in which equity rather than the supply of labor is the measure of the wage, and in which new taxes may be considered an equitable basis for wage increases. An administered wage may also reflect "equitable" shifting of new business taxes to labor.

26. *See generally* J. PECHMAN & B. OKNER, *supra* note 19, at 44–65 (1974).

FIGURE 2.
SOME FAMILIAR TAXES AND THEIR PREDICTED INCIDENCE[a]

TYPE OF TAX		*INCIDENCE*	*EXCESS BURDEN*
SALES	general	all consumers	relative consumption of goods unaltered
	selective	distributed between sellers and consumers of taxed goods as a function of the elasticities of supply and demand	relative consumption of goods altered
PROPERTY	general	consumers of housing and all owners of capital	relative mix of factors of production unaltered
	selective	*in the short run* owners of taxed capital; *in the long run* all owners of capital	relative mix of factors of production altered
INDIVIDUAL INCOME	general	income recipients	investment and labor patterns unaltered
	selective	*in the short run* recipients of taxed income; *in the long run* all income recipients	investment and labor patterns altered

a. This table is a simplification based upon assumptions made in the text. "The short run" is defined as the turnaround time for capital reinvestment.

rate that instead optimizes the mix of revenue and growth. If jurisdiction *B* now imposes a tax, jurisdiction *A* loses both revenue and growth. *B*'s tax may be so high that no reduction in *A*'s rate will restore the growth conditions contemplated by *A*'s original tax scheme. This would certainly be true if *B* is interested only in revenue and taxes at the yield-maximizing rate.[27]

Multiple taxation results in tax hierarchies organized by priority. The United States has a priority over state and local tax authorities as a creditor of the taxpayer, for example. Tax hierarchies reflect political hierarchies because a jurisdiction can assume a priority only by

27. These problems are alleviated if one jurisdiction allows taxpayers to deduct or credit tax payments made to the other. The federal income tax schedule permits deduction of state taxes and, as a rule, states permit deduction of federal income taxes. *See* G. Break, Intergovernmental Fiscal Relations in the United States 39–42 (1967); J. Pechman, *supra* note 13, at 87; Bridges, *Allowances for State and Local Nonbusiness Taxes,* in Essays in Fiscal Federalism 187 (R. Musgrave ed. 1965).

agreement or by having constitutional power to impose its will on competing jurisdictions. Difficulties usually arise when two coequal political subdivisions find themselves competing for the same tax base.[28]

In addition to tax hierarchies there is a "tax geography" resulting from local tax differentials which are an inevitable part of our system of political decentralization. This geography can be thought of as consisting of "hills" and "valleys"—places with relatively high and low aggregate tax burdens. Like water, commerce tends to accumulate in the deepest valleys. Changing the flow of wealth in this system requires either that the hills be made a little lower or the valleys shallower, so that the net difference in tax burden is reduced. Tax valleys are unlikely to raise their taxes for the sake of their neighbors. Therefore tax hills must either cut their taxes and absorb a revenue loss or call on Congress to make adjustments through the national income tax system and public spending.

Frustration of tax goals as a result of multiple and differential taxation is the price local jurisdictions pay for the privilege of participating in federalism. Local regultory differentials are also costly for business. They involve adaptation to and accounting for many sets of rules and payment of many different, overlapping, and often inconsistent explicit and implicit taxes. Unequal taxes distort the free market geographic allocation of capital, labor, and technology, and often frustrate efficient regional specialization.[29] The framers of the Constitution chose to limit, but not to eliminate, local regulatory differentiation. Local tariffs and duties are constitutionally prohibited, for example, but local domestic taxation is not. Our system balances local regulatory autonomy against the cost to business and government of regulatory overlap.[30] It is within this federalism model that the law of taxation of Indian property and tribal areas is best understood.

III. FEDERAL TAXATION

Tax law is said to be a matter of statutory interpretation, of locating and construing code provisions and regulations. The distinguishing feature of Indian tax law, however, is the absence of statutes. Indians are not mentioned in the Internal Revenue Code. Indian tax

28. *See generally* G. BREAK, *supra* note 27, at 28–61 (intergovernmental tax coordination).

29. *See* R. MUSGRAVE & P. MUSGRAVE, *supra* note 13, at 454.

30. *See* J. MAXWELL, FINANCING STATE AND LOCAL GOVERNMENT 27–32 (rev. ed. 1969) (federalism in intergovernmental financial matters).

law is a judicial creation in empty legislative space. The result is great inconsistency in application.[31] According to some commentators, federal law regards Indians as beneficiaries of a national trust for their protection and welfare.[32] The terms of this implied trust are nowhere spelled out. Nevertheless, the idea of trusteeship throws a rather indistinct shadow on all federal Indian tax law; the very notion of federal taxation of reservation Indians may be criticized as taxing the beneficiary for the benefit of the trustee.[33]

A. *Federal Tax Treatment of Allottees and Assignees of Trust Land*

1. *The starting point:* Squire v. Capoeman

In *Squire v. Capoeman,*[34] a Quinault Indian allottee challenged the application of the federal capital gains tax to the severance of timber from his land as a violation of trust. The General Allotment Act[35] im-

31. *See* United States v. Critzer, 498 F.2d 1160, 1162 (4th Cir. 1974): "As a matter of law [an Indian taxpayer] cannot be guilty of willfully evading and defeating income taxes on income, the taxability of which is so uncertain that even co-ordinate branches of the United States Government plausibly reach directly opposing conclusions." The Internal Revenue Service imposes no time limit on Indians' claims for refund of overpaid taxes when the Bureau of Indian Affairs completed the tax returns. Rev. Rul. 68-172, 68-1 C.B. 563.

32. *See* STAFF OF AMERICAN INDIAN POLICY REVIEW COMM'N, REPORT ON TRUST RESPONSIBILITIES AND THE FEDERAL-INDIAN RELATIONSHIP; INCLUDING TREATY REVIEW 2-3, 21-26, 47 (Comm. Print 1976).

33. An early opinion of the Attorney General of the United States is an apt example of the trust concept. The Attorney General was

> unable, by implication, to impute to Congress under the broad language of our Internal Revenue Acts an intent to impose a tax for the benefit of the Federal Government on income derived from the restricted property of these wards of the nation; property the management and control of which rests largely in the hands of officers of the Government charged by law with the responsibility and duty of protecting the interests and welfare of these dependent people. In other words, it is not lightly to be assumed that Congress intended to tax the ward for the benefit of the guardian.

34 OP. ATT'Y GEN. 439, 445 (1925), *quoted with approval in* Squire v. Capoeman, 351 U.S. 1, 8 (1956).

34. 351 U.S. 1 (1956).

35. Act of Feb. 8, 1887, ch. 119, 24 Stat. 388 (codified as amended at 25 U.S.C. §§ 331-389 (1976)). Indians were individually allotted lands on their reservations, but the United States government retained title to the lands in trust. Up to 25 years after allotment, the allottees were to receive the lands in fee, discharged of the trust and free of any incumbrances. 25 U.S.C. §§ 348, 349 (1976). *See Capoeman,* 351 U.S. at 3. The policy of allotment was discontinued by the Indian Reorganization Act of 1934, and the trust status of already allotted lands was extended indefinitely. Act of June 18, 1934, ch. 576, 48 Stat. 984 (codified as amended at 25 U.S.C. §§ 461-479 (1976)). *See* 25 U.S.C. §§ 461, 462 (1976).

posed federal supervision over parcels of this kind, purportedly to protect Indian possession and to accelerate Indian economic development.[36] When the act was passed in 1887 there was no federal tax applicable to land ownership, but *Capoeman* arose after enactment of the national income and capital gains taxes. The Supreme Court faced an intriguing question for which there was no relevant legislative history: Did the 1887 policy of encouraging individual Indian land development override the subsequent establishment of a national tax system?

The Court concluded that the protective policy of the allotment laws had been specific enough to survive enactment of later general revenue laws. It observed with evident sympathy that the Bureau of Indian Affairs had determined how, when, and at what price allottees' timber should be cut; that after severance of the timber Capoeman's allotment was virtually worthless; and that the United States' use of its power as trustee to convert Capoeman's tax-exempt property into taxable income seemed to suggest as much a conflict of interest as a conflict of policy.[37] The capital gains tax was inapplicable to Capoeman because it constituted a direct tax on the value of federally-protected land. If Capoeman were to reinvest the tax-exempt income, however, any proceeds of the reinvestment would be taxable. According to the Court, "it is not necessary to exempt reinvestment income from tax burdens" in order to implement the federal policy of protecting Indian ownership and encouraging economic development.[38]

It is not clear why the implicit protective policy of allotment is broad enough to immunize the allottee from taxes on land income, but not from income taxes generally. Any tax on income reduces the allottee's capital resources and therefore his ability to develop his allotment.[39] In distinguishing between direct land income and reinvestment income for tax purposes, *Capoeman* read into the General Allotment Act only a *limited* congressional interest in accelerating Indian economic development.

Our national income tax system encourages reinvestment by means

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36. *Capoeman,* 351 U.S. at 8, 10.

37. *Id.* at 8, 10.

38. *Id.* at 9. The distinction between tax-exempt direct income and taxable reinvestment income was also necessary for the Court to distinguish away its earlier decision in Superintendent of Five Civilized Tribes v. Commissioner, 295 U.S. 418, 420–21 (1935).

39. In its brief the government argued that an income tax is "not the same as the tax on the source of the income, the land." *Capoeman,* 351 U.S. at 6. A distinction between a tax on capital and a tax on income from capital is meaningless economically, and the Court did not accept it.

of investment tax credits and capital gains treatment of investment income. According to *Capoeman,* Congress intended to encourage Indians to invest only in land. This restriction of Indians' relative tax advantage may result in an inefficient overallocation of reservation capital to agriculture, forestry, ranching, and other "primary products" industries relative to manufacturing and retailing.[40]

2. *IRS limitations on the scope of* Capoeman's *tax exemption*

For twenty years the Internal Revenue Service has tried to read *Capoeman* as narrowly as possible. Shortly after the Supreme Court's decision, Revenue Ruling 56–342 exempted from taxation "[i]ncome . . . derived directly from [the taxpayer's own] allotted and restricted Indian lands."[41] This formula limits the exemption in two ways: to income derived from land and to income from the allottee's own allotted land. The meaning of "income derived from land" is, however, far from clear. Land is a factor, to a greater or lesser extent, in the production of *all* income. It can be mined, support renewable resources such as timber and crops, or serve as the site for industrial facilities. And the income produced from it can help finance everything else.

The ambiguity of the distinction and the IRS reluctance to expand tax exemptions led to hairsplitting and economically questionable applications. Income from renting the land for ranching or from the sale of hay was directly derived from land and, accordingly, tax-exempt,[42] but income from the sale of livestock raised by the allottee on the allotment was said not to be derived from the land and so was taxable.[43]

40. *But cf.* Critzer v. United States, 77-2 U.S. TAX CAS. ¶ 9540 (Ct. Cl. Trial Div. No. 134-75, July 12, 1977) (proceeds of trust land development are tax-exempt when reinvested in commercial activities on the land). *See* notes 60-66 and accompanying text *infra.*

41. Rev. Rul. 56-342, 1956-2 C.B. 20. The exempt income included "[rents], royalties, proceeds of sales of the natural resources of such land, and income from the sale of crops grown upon the land and from the use of the land for grazing purposes." *Id. Cf.* Lafontaine v. Commissioner, 533 F.2d 382 (8th Cir. 1976) (Indian's wages not tax-exempt under any treaty or statute).

42. Rev. Rul. 56-342, 1956-2 C.B. 20.

43. Rev. Rul. 58-64, 1958-1 C.B. 12, 13. Revenue Ruling 58-64 was modified in 1960 to correct its most obvious inequities. *See* note 44 *infra.* Under the 1958 ruling all income from the sale of allotment cattle was taxable. Thus, an allottee could sell hay from his pasture tax-free, or lease the pasture to someone else for grazing and enjoy the rental income tax-free, but if the allottees raised their own cattle, the proceeds from the sale, including the value of the allottees' own grazing use of the land, would be taxed. The 1958 ruling actually penalized Indian uses of the land, although taxing Indian uses of Indian grazing land and subsidizing the leasing of the land to non-Indians are opposite the goals of the General Allotment Act as interpreted in *Capoeman. See* note 36

In 1960 the IRS reconsidered this distinction and proposed to tax the allottee-rancher only to the extent that his ranching income represented his own labor rather than the productive value of the land.[44] For this purpose the difference between the price of the livestock and the reasonable rental value of the acreage was treated as the value of the allottee's labor.[45] Taxing allottee-farmers on the labor component of crop sale income was not considered, although farm income, like ranch income, is a product of both land and labor.

In either case, the IRS taxed the behavior *Capoeman* said Congress intended to encourage: allottees using their own land. The IRS also discriminated against ranching as an economic activity. Could Congress have intended to encourage more Indians to become farmers than ranchers? Some reservations and parts of reservations are better suited to one or the other of these industries; neither is a "better" economic activity everywhere. The IRS finally made livestock and crop sales equally tax-exempt in 1962, not out of any policy considerations but because the calculation of the labor component of livestock proceeds had proven too complicated to apply.[46]

Revenue Ruling 56–342 also limited tax exemptions to income from the Indian allottee's own allotment.[47] On many large reservations, however, tribal land was never allotted or was repurchased by the tribes from allottees.[48] The 1934 Indian Reorganization Act[49] sus-

and accompanying text *supra*. It might be argued that a tax on the non-Indian lessees' income would simply be shifted to the Indian lessors in any event, making it immaterial to the lessor whether he leased or used the land himself. The conventional wisdom among economists, however, is that income taxes are borne by the taxpayer. J. PECHMAN & B. OKNER, *supra* note 19, at 26. But suppose, for argument's sake, that lessees' income taxes are shifted completely to Indian lessors. Since Indian lessors' rental income is tax-exempt they still would enjoy a relative advantage over non-Indian lessors, while Indian farm or ranch operators would enjoy no tax advantage over non-Indian farm or ranch operators. The net effect still would be to encourage leasing.

44. Rev. Rul. 60–377, 1960–2 C.B. 13. This modification of Revenue Ruling 58–64 solved the anomaly of taxing an allottee's own use of grazing land while not taxing regrazing value when the allottee leased it to another. This was but a slight improvement. The tax laws merely no longer penalized Indians' own use of their ranching land, but they provided no incentive for an allottee to use his own land rather than lease it or use it less efficiently in farming.

45. Revenue Ruling 60–377 gave no theory for its allocation of the proceeds of livestock sales into tax-exempt and taxable portions. Rev. Rul. 60–377, 1960–2 C.B. 13. But according to Revenue Ruling 62–16, the allocation of livestock sales proceeds was done by the portion "attributable to the land," which was tax-exempt, and the "portion attributable to other factors, such as labor, the use of equipment, and the like," which was taxable. Rev. Rul. 62–16, 1962–1 C.B. 7, 8.

46. Rev. Rul. 62–16, 1962–1 C.B. 7,8.

47. Rev. Rul. 56–342, 1956–2 C.B. 20.

48. *See* STAFF OF AMERICAN INDIAN POLICY REVIEW COMM'N, *supra* note 1, at 23.

49. Act of June 18, 1934, ch. 576, 48 Stat. 984 (codified as amended at 25 U.S.C. §§

pended further allotment of tribal lands and provided repurchase financing, reflecting the growing belief that allotments had been too small to begin with and had been further divided to an inefficient degree as the result of statutory heirship rules.[50] Unallotted or repurchased tribal land is often leased or assigned to an individual tribal member for cultivation. Similarly, holders of fractional shares of allotments often transfer or lease their land to an adjacent allottee who then works the larger combined tract.

Although the Court in *Capoeman* found a federal tax exemption for allotments in the *implicit* policy of Congress, Revenue Ruling 58–320 concluded that federal tax exemptions for other kinds of reservation land must be found in the *explicit* policy of Congress.[51] This amounts to a presumption in favor of taxability. Since no law expressly exempts repurchased and original unallotted lands from federal taxation, they must be taxable. One purpose of the Indian Reorganization Act was to reverse the diseconomical tendency of allotment to break up Indian land into unworkably small, noncontiguous parcels, but Revenue Ruling 58-320 actually subsidized the use of these unworkably small parcels relative to larger, consolidated tribal tracts reacquired for tribes with federal funds[52] and thus encouraged capital to flow from federally-financed tribal land developments to allotments.[53]

3. *Revenue Ruling 67–284 and its critics*

Revenue Ruling 67–284 is the most recent comprehensive statement of Indian tax regulations. Indian income is exempt only if protected by a specific treaty or federal statutory provision, or if "derived

461–492 (1976)). Especially pertinent are 25 U.S.C. §§ 461, 462, 463(a), 465, 467 (1976). Section 5 of the Act, 25 U.S.C. § 465 (1976), expressly exempts all repurchased reservation lands from state and local taxation; but the Act makes no references to federal taxation of repurchased land and original unallotted tribal lands.

50. *Readjustment of Indian Affairs: Hearings on H.R. 7902 Before the House Comm. on Indian Affairs,* 73d Cong., 2d Sess. 15–29 (1934) (memorandum submitted by Commissioner of Indian Affairs).

51. Rev. Rul. 58-320, 1958-1 C.B. 24.

52. Small, uneconomic parcels are tax-exempt as long as they are used by the allottee. But if small parcels are consolidated for more efficient economic use, the benefit of tax exemption is lost. Moreover, since as a result of fractional heirship most allottees today can claim only a few acres, an industrious allottee has little choice but to buy out or lease from fellow heirs and neighbors. Taxing the consolidated portions of farms and ranches hinders Indian economic growth and, at the extreme, is an incentive for keeping the allotments fractionated.

53. The only difference between an allottment and a tribal land assignment in current practice is the source of the proprietor's title. The tax thereby becomes a tax on ancestry or inheritance rather than wealth or consumption. The IRS obviously does not

directly by a noncompetent Indian from allotted and restricted land held under the General Allotment Act" or a similar law.[54] The rule preserves allottees' inexplicable and horizontally inequitable tax advantage over other forms of individual Indian landholding and continues the tax advantage of certain forms of land use. Continuing prior practice, the rule defines income "derived directly" from the land as rentals, royalties, sales of crops and livestock, sales of natural resources, and sale of the land itself.[55] This appears to exclude commercial development. If an allottee leases to a retailer or manufacturer his rental income is exempt. However, if he operates a business on his own land, he must pay tax. Leasing and agriculture are subsidized relative to other uses.

The IRS position has, at least in part, been challenged successfully in the courts. In *Stevens v. Commissioner*[56] the Ninth Circuit effectively overthrew tax discrimination against allottees' purchases of additional allotments. The court reasoned that an exemption for purchased lands would be consistent with the Indian Reorganization

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agree with the concept that "it is not lightly to be assumed that Congress intended to tax the ward for the benefit of the guardian." 34 OP. ATT'Y. GEN. 439, 445 (1925).

54. Rev. Rul. 67-284, 1967-2 C.B. 55, 56. A "noncompetent" Indian is merely "one who holds allotted lands under a trust patent and may not dispose of his property without the approval of the Secretary of Interior. It does not denote mental incapacity." Stevens v. Commissioner, 452 F.2d 741, 742 n.1 (9th Cir. 1971).

Revenue Ruling 67-284 outlines the following five-point test to determine the exempt status of Indian land income:

(1) The land must be in trust status, *i.e.*, the record owner is the United States in trust for an Indian or Indians. Once the United States conveys fee title to the beneficiary the exemption ceases. *See also* Rev. Rul. 62-48, 1962-1 C.B. 131 (base for computation of capital gains on the sale of a former allotment by the "emancipated" allottee).

(2) The land must be allotted to an individual or individuals, not held for the tribe as a whole.

(3) The income must be "derived directly" from the land, not produced by "reinvestment" of land income. *See* notes 40 & 41 *supra*. Directly derived income includes "rentals . . . , royalties, proceeds from the sale of the natural resources of the land, income from the sale of crops grown upon the land and from the use of the land for grazing purposes, and income from the sale or exchange of cattle or other livestock raised on the land," and income from sale of the land itself. Rev. Rul. 67-284, 1967-2 C.B. 55, 57. *See also* Rev. Rul. 69-289, 1969-1 C.B. 34 (agricultural stabilization payments are income "derived directly" from the land); Rev. Rul. 57-407, 1957-2. C.B. 45 (sales of allotted land still held in trust).

(4) If the exemption is claimed under some law other than the General Allotment Act, the law must "evince congressional intent that the allotment be used as a means of protecting the Indian" until he is "competent," *i.e.*, until he is legally enabled to dispose of it without federal supervision.

(5) If the exemption is claimed under some law other than the General Allotment Act, the law must express Congress' "clear intent" that the allotment be nontaxable.

55. Rev. Rul. 67-284, 1967-2 C.B. 55, 57.

56. 452 F.2d 741 (9th Cir. 1971).

Act's policy of resisting allotment's "serious diminution of Indian land base . . . which, through the process of intestate succession, had resulted in many Indians holding uneconomical fractional interests of the original allotments."[57] Reluctant to rely on economic policy alone to support its holding, however, the court fictionalized Bureau of Indian Affairs approval of allottee's land purchases into purchases of land for allottees by the United States, which are statutorily tax-exempt.[58] Both the policy and this fiction should have been applicable equally to allottees' purchases of other Indians' allotted land, of non-allotted tribal land, and even of non-Indian-owned fee land, but further extension of *Stevens* seems unlikely.[59]

Income tax discrimination against development on nonallotted tribal land and tax discrimination against reservation commercial development were tested inconclusively in *Critzer v. United States*.[60] The Indian owner of a prosperous motel on nonallotted tribal land sought reimbursement of business income taxes. Evidently sympathetic,[61] the trial division of the Court of Claims concluded that the motel income should have been exempt. Two different reasons were given, one of them applicable only to Critzer's North Carolina Cherokee reservation. Entirely adequate to dispose of the case, the narrow ruling involved the specific language of the 1924 act extending the allotment policy to the Eastern Band of Cherokees.[62]

The trial division of the Court of Claims went on, however, to use

57. *Id.* at 748.

58. *Id.* at 747–49. *See* 25 U.S.C. §§ 335, 465, 747 (1976).

59. *Cf.* Fry v. United States, 557 F.2d 646 (9th Cir. 1977), *cert. denied,* 98 S. Ct. 72 (1978) (in circumstances functionally similar to tribe member's lease or use by permit of tribal land, tribe member's income from cutting timber on such land is not tax-exempt); Holt v. Commissioner, 364 F.2d 38, 41 (8th Cir. 1966), *cert. denied,* 386 U.S. 931 (1967) (Indian's ranching income from cattle operations on tribal land used pursuant to grazing permit is taxable).

60. 77-2 U.S. TAX CAS. ¶ 9540 (Ct. Cl. Trial Div. No. 135-75, July 12, 1977). *See also* United States v. Critzer, 498 F.2d 1160 (4th Cir. 1974) (earlier related case, held no criminal tax liability for nonpayment of taxes here in question).

61. *See, e.g.,* 77-2 U.S. TAX CAS. ¶ 9540 at 87,818: "And so it seems that Mrs. Critzer became too rich too fast to suit the [tax] gatherer. Had her profits been those of a humble Indian farmer or cattle grazer, there is little reason to feel that she would have aroused the Collector's appetite . . . ."

62. Unlike the General Allotment Act which refers only to the status of allotments, the Cherokee act expressly declares that "all restricted allotments *and undivided property* shall be exempt from taxation." Act of June 4, 1924, ch. 253, § 21, 43 Stat. 376, 381, 25 U.S.C. § 331 (note) (1976) (emphasis added). *See* Critzer v. United States, 77-2 U.S. TAX CAS. ¶ 9540 at 87,816. Critzer's possessory holdings of tribal land were "undivided property" within the meaning of the act. The language places Eastern Cherokee squarely within the Internal Revenue Service's category of exemption by the "clear intent" of Congress.

reasoning applicable to most other reservations. Where tribal assignment of land to an individual Indian "possesses all of [the] significant attributes" of an allotment, that is, inalienability in fee, it should be tax-exempt, just as an allotment would be.[63]

On policy considerations, the court also rejected the IRS interpretation of income "directly derived" from the land. The court said the purpose of the tax exemption is to foster Indian economic advancement generally; any productive use of the land is within the scope of the exemption.[64] "[T]he plaintiff is utilizing to its best advantage the land that Congress had declared to be exempt. Such utilization clearly falls within the Congressional intent that Indians improve themselves economically so that they may take their rightful place in civilized society."[65]

Although it exposed the absurdity of subsidizing only primary uses of Indian land, *Critzer*'s reliance on the unique provisions of the Cherokee allotment law makes its influence uncertain. It remains to be seen whether it will be followed narrowly or broadly.[66]

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63. Critzer v. United States, 77-2 U.S. TAX CAS. ¶ 9540 at 87,815-16. Land on the North Carolina Cherokee reservation had never been allotted; the allotment policy had been terminated by the Indian Reorganization Act prior to any allotments. In order to effect tribe members' individual use of the land, the tribe had created certificates of possessory holding for parcels of tribal land which gave tribe members use of the parcel to the same extent as an allotment, except that title always remained in the United States in trust for the tribe and the tribe had certain supervisory powers. *Id.* at 87,813-14. A tribal assignment by way of such possessory holding may be distinguished from more temporary leases or permits. *See* cases cited at note 59 *supra*.

64. Critzer v. United States, 77-2 U.S. TAX CAS. ¶ 9540 at 87,817. The court also declared:

> Congress scarcely intended the tax exemption to be an incentive to the Indians to use their lands in the most primitive ways possible, so that the income derived therefrom would be "derived directly" from "raw land" and therefore tax exempt. The exemption was not granted by Congress in order to foster economic backwardness among the Indians.

Id.

The "derived directly" requirement was to distinguish income derived from use of the land from reinvestment income, not to distinguish among uses of the land. *Id.* Thus, business income from Critzer's motel and restaurant is tax-exempt, but if such income is put in a bank account or invested in stocks, any interest, dividends, or gains on sale of stock are taxable as reinvestment income.

65. *Id.* Critzer's land was unsuitable for farming, ranching, or timber production. *Id.* at 87,814. Under the circumstances, a motel represented the "highest, best, and only use" of Critzer's land assignment. *Id.* at 87,814. *See also id.* at 87,817-18.

66. *Critzer* has not resulted in any official clarification of Revenue Ruling 67-284. The Supreme Court declined the opportunity to review its theory in other cases, *e.g.*, Fry v. United States, 557 F.2d 646 (9th Cir. 1977), *cert. denied*, 98 S.Ct. 72 (1978); Holt v. Commissioner, 364 F.2d 38 (8th Cir. 1966), *cert. denied*, 386 U.S. 931 (1967).

B. *Taxation of the Tribe and Tribal Instrumentalities*

According to Revenue Ruling 67–284 the tribe itself is exempt from income taxation.[67] Although salutory, there is no express statutory basis for this position. The Internal Revenue Code exempts the income of United States possessions,[68] the income of a state or its subdivisions derived from a public utility or an essential governmental function,[69] and the income of federal corporations expressly made tax-exempt by their act of incorporation.[70] Tribes are functionally analogous to state and territorial governments, and many tribes are incorporated under the Indian Reorganization Act,[71] but no tribe precisely fits the statutory conditions of tax exemption. Nevertheless, the tax exemption of tribes is well established.

Federal tax treatment of tribes generally is similar to the treatment of other subfederal governments, but in certain instances it is more restrictive. The IRS considers interest on tribal revenue bonds taxable because there is no express statutory exemption of tribal bond interest.[72] It seems strange that the tribe's bonds are taxable for lack of express statutory language when the tribe itself is exempt by analogy at best. It is stranger still because it should be in the United States' own financial interest to exempt tribal bond interest from income taxation, since tribes are more dependent on federal financial support when they cannot compete with tax-exempt state and municipal bonds in private capital markets.[73]

Unlike other subfederal governments, tribes commonly engage in a variety of for-profit business enterprises. Are tribal enterprise profits taxable? The statutory test applicable to states and municipalities distinguishes between essential governmental functions and proprietary activities,[74] but this analysis is difficult to extend to tribes. States generally finance services out of taxes and borrowing and have little need

67. Rev. Rul. 67-284, 1967-2 C.B. 55, 58.
68. I.R.C. § 115(2).
69. *Id.* §115(1).
70. *Id.* §501(c)(1).
71. 25 U.S.C. § 477 (1976).
72. Rev. Rul. 68-231, 1968-1 C.B. 48.
73. Representatives Ullman and Udall unsuccessfully sponsored a bill in 1977 to equalize tribal and state status with regard to bond interest as well as public scholarships, political contributions, and employer contributions to retirement plans. H.R. 4089, 95th Cong., 2d Sess. (1977).
74. For states and municipalities, income is exempt only when derived from a public utility or an essential government function. I.R.C. § 115(1). For United States possessions, however, there is no such restriction on exempt income. *Id.* § 115(2). It is unclear which rule would be applied to tribes.

to turn to "private" enterprises. Economically depressed, with little tax base and at a competitive disadvantage in public bond markets, tribes, however, have little alternative for public finance.[75] Tribes often raise revenue for public works, social services, education, and transfer payments by operating businesses. Tribal revenue may be taxable simply because it is raised by means different than those of other subfederal governments. Tracing the use of revenue rather than its source would seem to be a better approach.

Whether or not tribal revenue is taxable in tribal hands, it is taxable when paid by the tribe to its officers or employees as compensation,[76] or when paid by the tribe to its members as a distribution or income supplement.[77] Federal and state transfer payments to individuals are ordinarily tax-exempt on the sensible theory that it would be futile to tax back what was purposely given. And most federal payments to individual Indians such as land claims judgment distributions are also statutorily tax-exempt.[78] Nevertheless, Revenue Ruling 67–284 classifies tribal "per capita" payments to tribal members as taxable income.[79] Administratively, per capitas are equal dividends out of the tribe's budget surplus. Because reservation incomes vary little and tend to fall below the poverty level, however, a system of need-adjusted payments would differ very little from equal payments. Calling tribal payments "welfare" and making them ostensibly need-adjusted in order to win them exempt status would simply involve wasteful administrative cost.[80]

C. *Taxability of Treaty Rights*

An interesting byproduct issue of the recent controversy over treaty hunting and fishing rights is the taxability of income from the exercise of those rights. If an activity is protected from federal and state inter-

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75. *See generally* Barsh & Henderson, *Tribal Administration of Natural Resource Development*, 52 N.D.L. REV. 307 (1975).

76. Commissioner v. Walker, 326 F.2d 261 (9th Cir. 1964); Rev. Rul. 67-284, 1967-2 C.B. 55, 58; Rev. Rul. 59-354, 1959-2 C.B. 24.

77. Choteau v. Commissioner, 283 U.S. 691, 697 (1931); Rev. Rul. 67-284, 1967-2 C.B. 55, 58.

78. *See, e.g.*, 25 U.S.C. § 1407 (1976) (Indian Claims Commission judgments); Rev. Rul. 77-77, 1977-1 C.B. 11 (nonreimbursable grants under Indian Financing Act of 1974).

79. Rev. Rul. 67-284, 1967-2 C.B. 55, 58.

80. Fear that tribes could immunize their members from income taxes by taking a paper interest in all reservation businesses and paying everyone per capitas is misplaced, at least as long as reservation incomes are so low that welfare is necessary.

ference by a treaty, how can it be taxed without a modification of the treaty or an act of Congress clearly expressing an intention to disregard the agreement?[81]

The only consideration of this problem antedates all of the recent litigation in the Northwest. In *Charles Strom*[82] the Tax Court in 1946 held that income from a Quinault Indian's fishing pursuant to the Quinault Treaty is taxable by the United States. The Tax Court agreed that the treaty guaranteed protection of the tribe's right to fish but said that the "disputed income tax is not a burden upon the *right to fish,* but upon the income earned through the exercise of that right."[83] A ten per cent cutback in fishing days presumably would be a prohibited burden, but a ten per cent tax on the fishermen's income would not be a burden.[84] Nothing could be a more perfect fiction, for the "right to fish" is meaningless unless it comprehends the value of its exercise. For the owner of the right, it is irrelevant whether we tax it or restrict its exercise; in either case the net value of having it is diminished. It does not matter whether we halve the number of fish caught, or tax away half of their value to the fisherman. The burden of a tax on the output of capital is borne by owners.

Reasoning like *Strom*'s was proposed by the Internal Revenue Service but rejected by the Supreme Court in *Capoeman*.[85] If the income "directly derived" from an allotment is as exempt as the land itself, the income "directly derived" from a treaty right also must be as exempt from taxation or interference as the treaty right itself. Increased commercial exercise of treaty fishing rights in the Pacific Northwest in the past four years undoubtedly will trigger relitigation of this issue.

D. *Special Federal Taxes on Tribal Property*

The "directly derived from allotments" test of Revenue Ruling 67–284 limits federal income tax exemptions to only about one-fifth of all

81. The traditional canon of construction for Indian treaties and legislation would seem appropriately applied here. "Doubtful expressions are to be resolved in favor of the weak and defenseless people who are the wards of the nation, dependent upon its protection and good faith." Carpenter v. Shaw, 280 U.S. 363, 367 (1930).

82. Charles Strom, 6 T.C. 621 (1946), *aff'd per curiam,* 158 F.2d 520 (9th Cir. 1947).

83. *Id.* at 627 (emphasis in original). *But see* Mason v. Sams, 5 F.2d 255 (W.D. Wash. 1925).

84. "It is undoubtedly true that the Federal Government is not empowered to lay a tax upon the exercise of the right of the petitioners [Quinault Indians] to fish in the waters of this reservation." Charles Strom, 6 T.C. at 628. The court gave no explanation for the very fine distinction thus made.

85. 351 U.S. at 6 (quoting IRS brief).

reservation land and to roughly one-tenth of all reservation Indian income-earners.[86] It is difficult to see why Indians' federal "trustee" is concerned about Indian taxpaying at all, however. With a median family income of only $4,008 at the last census, reservation Indians do not represent a significant tax base. Even if fully taxed, reservation Indians would not add more than .01% to national personal income tax collections.[87] This negligible potential yield scarcely seems worth the risk of prolonging tribal poverty. It is therefore remarkable that *federal law imposes additional taxes on Indians* not levied on other citizens.[88] The most pernicious is the "administrative fee" authorizing the Secretary of the Interior "to collect reasonable fees to cover the cost of any and all work performed for Indian tribes or for individual Indians, to be paid by vendees, lessees, assignees, or deducted from the proceeds of sale, leases, or other sources of revenue."[89] Collections are deposited to the Bureau of Indian Affairs' account in the Treasury under the euphemism, "Indian Moneys, Proceeds of Labor" or IMPL, where they are available for disposal by the agency for its own uses without additional budgetary authorization.[90]

The discretionary nature of this tax[91] has resulted in a variety of inconsistent applications. Bureau regulations currently provide for a 10% tax on the "gross amount received for timber sold" from individual and tribal trust lands, or 5% where "little administrative expense . . . is required";[92] for a tax of 3% on the first $500, 2% on the

86. S. LEVITAN & W. JOHNSTON, INDIAN GIVING: FEDERAL PROGRAMS FOR NATIVE AMERICANS 17–19 (1975). *See generally* ECONOMIC DEVELOPMENT ADMINISTRATION, U.S. DEP'T OF COMMERCE, FEDERAL AND STATE INDIAN RESERVATIONS (1974); BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION: SUBJECT REPORT: AMERICAN INDIANS (1973).

87. Computed from data in sources cited in note 86 and 1977 federal income tax schedules. Maximum tax payable by Indian families in each income bracket reported in the census was computed, totaled, and then compared with total federal personal income tax collections.

88. "Tax" is used here in the broad sense of any cost added to activities by public action. *See* note 5 and accompanying text *supra*.

89. 25 U.S.C. § 413 (1976).

90. The government's position is summarized in two recent documents. Memorandum from Deputy Assistant Secretary—Indian Affairs to Area Directors (August 16, 1978) ("Bureau Policy on the Expenditure of Indian Money, Proceeds of Labor Funds") (copy on file with *Washington Law Review*); Memorandum from Assistant Secretary—Indian Affairs to Area Director, Portland, Ore. (July 17, 1978) ("Use of IMPL Funds") (copy on file with *Washington Law Review*).

91. The Secretary collects the fees "in his discretion, and under such rules and regulations as he may prescribe." 25 U.S.C. § 413 (1976).

92. 25 C.F.R. § 141.18 (1978). Choctaw Nation v. United States, 91 Ct. Cl. 320, 369 (1940), in a related context, construed the word "proceeds" in the statute to mean

next $4500, and 1% on the next $5000 of the gross rental in any lease of individual or tribal trust land for grazing or other purposes, with a maximum tax of $250;[93] and for simple $10 fees on mining leases and sales.[94] In the fiscal year ending June 30, 1976, $34 million or 31% of all proceeds of natural resource exploitation on tribal land in the United States was subject to the 10% gross tax, and the Bureau deposited $3.7 million to its IMPL account.[95] Thus, Indians, who are the objects of an involuntary "trust" imposed on them by law for their "protection," have to pay for its administration. But there is no evidence that this special tax-supported involuntary management process adds significantly to the resource management abilities of an Indian reservation. On the contrary, federal management may actually misdirect and reduce the net value of transactions in Indian resources.[96]

Although the Bureau by regulation presently limits its "fee" on mineral exploitation to $10,[97] federal law also empowers the states to tax production of "oil and gas and other minerals" on unallotted tribal lands.[98] The states lack any other power to regulate or supervise tribal mineral development, however.[99] The net effect is that state taxes on state and tribal mining operations return state benefits only

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gross revenue less cost of sale. Apparently the Bureau does not follow this interpretation.

93. 25 C.F.R. §§ 131.13(b)(1) (general leasing), 151.22 (grazing permits) (1978).

94. *Id.* §§ 171.25, 172.31 (1978).

95. This IMPL deposit represents an amount equal to about 4% of the Bureau's total annual budget for resource management and administration and 13% of its budget for forestry operations alone. OFFICE OF MANAGEMENT AND BUDGET, THE BUDGET OF THE UNITED STATES GOVERNMENT —1977 APPENDIX 748 (1976); DEP'T OF THE TREASURY, COMBINED STATEMENT OF RECEIPTS, EXPENDITURES AND BALANCES OF THE UNITED STATES GOVERNMENT (for the fiscal year ending June 30, 1976) at 100 (accounts 14-8500.3 (new IMPL deposits) and 14-8500.2 (interest)) [hereinafter cited as COMBINED STATEMENT]. Per dollar of gross resources income, it costs the Bureau of Indian Affairs about seven times more to manage timber than to supervise mining, but this is far smaller than the difference between the effective rates of the "administrative fee" on these two activities. For example, on the sale of $1 million in timber the fee is either $50,000 or $100,000, while on a sale of $1 million of coal or oil the fee is $10, or at most 1/5000 as much.

96. *See* Barsh & Henderson, *supra* note 75, at 309–15. *See also* Trosper, *American Indian Relative Ranching Efficiency*, 68 AM. ECON. REV. 503 (1978). *See generally* STAFF OF AMERICAN INDIAN POLICY REVIEW COMM'N, *supra* note 1.

97. 25 C.F.R. § 171.25 (1978). *See* note 94 and accompanying text *supra*.

98. 25 U.S.C. § 398 (1976).

99. The one case directly testing state power to pool and unitize reservation oil leases was dismissed for technical flaws in the pleadings. Yoder v. Assiniboine & Sioux

to state operators. This redistribution of income is of considerable proportions. Mineral resources account for a little over half of all tribal trust land revenues.[100]

Federal law therefore subjects tribal economies to two special taxes, Bureau "fees" and state mineral taxes, in addition to most general federal income taxes. Both special taxes are levied on the primary value of most reservation land: natural resource exploitation. The combined effect of special taxes and general federal taxes may subject economic activity on reservations to a higher aggregate tax burden than identical off-reservation activities.[101] National data on personal Indian incomes indicates that tribal land development revenues account for almost 25% of all reservation Indian income, individual and tribal.[102] Tribal resources are typically owned and exploited by tribal enterprises and nearly half of all reservation Indian employment is in the public sector. The rate of growth in and the profitability of natural resource development is therefore especially crucial to Indian welfare, and the collection of special taxes on development is counter-productive.

IV. STATE TAXATION

Although more in the public eye in recent years than federal taxation of Indians and Indian resources, state taxation shares problems of legislative silence and inconsistent judicial interpretations. The case

Tribes, 339 F.2d 360 (9th Cir. 1964). Cases involving reservation enforcement of state zoning codes and fisheries management programs make state power to regulate reservation resource exploitation highly questionable. *See, e.g.*, Puget Sound Gillnetters Ass'n. v. United States Dist. Court, 573 F.2d 1123 (9th Cir.), *cert. granted*, 99 S. Ct. 277 (1978) (fisheries); United States v. Washington, 384 F. Supp. 312, 341 (W.D. Wash. 1974), *aff'd*, 520 F.2d 676 (9th Cir. 1975), *cert. denied*, 423 U.S. 1086 (1976) (fisheries); Snohomish County v. Seattle Disposal Co., 70 Wn. 2d 668, 425 P.2d 22 (1967) (zoning).

100. *See* COMBINED STATEMENT, *supra* note 95, at 99–100 (account 14-8365 (trust receipts)). *See also* H. HOUGH, DEVELOPMENT OF INDIAN RESOURCES 115–40 (1967) (surveying mineral revenues of tribes).

101. In addition to this extra tax burden, the chilling effect of Bureau of Indian Affairs "white tape," applicable only to transactions with tribes and tribal members, makes it easier to understand the persistent reluctance of business to invest in or finance reservation development. *See* Barsh & Henderson, *supra* note 75, at 314–27; Barsh, *Corporations and Indians: Who's the Villain?*, MBA, June 1975, at 11.

102. Computed from data in S. LEVITAN & W. JOHNSTON, *supra* note 86, at 11–33, and BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION: SUBJECT REPORT: AMERICAN INDIANS 151–57 (1973).

law has been exhaustively analyzed elsewhere,[103] but a synthesis of major trends and theories will be helpful here. In the development of federal decisions on state taxation of reservations, there have been three broad phases, each characterized by a different theory for the presence or absence of state taxing power.

A. *Phase I: Tribal Sovereignty*

In 1832, the Supreme Court ruled in *Worcester v. Georgia*[104] that states can exercise over tribes only those powers delegated to them by Congress, and that the United States itself has and can delegate only those powers of tribal self-government ceded to it by the tribes.[105] Thirty years later, the Supreme Court applied this theory of state power in *The Kansas Indians*[106] to an attempt by the state of Kansas to tax individual Indians on the Shawnee reservation. Recognized in its treaties with the United States as a distinct people with its own government, the Shawnees could not be subject to any federal or state power without their consent.[107] Finding no evidence that the Shawnees had ceded any inherent taxing or regulatory powers to the United States by treaty, either in the express language of the treaty or in the conduct of federal and tribal authorities, the Court concluded that the tribe retained the sole and exclusive power to tax reservation property.[108] Members of the tribe therefore were completely immune from state taxation.

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103. *See, e.g.*, J. WHITE, TAXING THOSE THEY FOUND HERE (1972); Barsh, *The Omen*: Three Affiliated Tribes v. Moe *and the Future of Tribal Self-Government,* 5 AM. INDIAN L. REV. 1 (1977); Comment, *State Taxation of Indians—Federal Preemption of Taxation Against the Backdrop of Tribal Sovereignty,* 49 WASH. L. REV. 191 (1975).

104. 31 U.S. (6 Pet.) 515 (1832).

105. *Id.* at 557–61. The Court stated:

> The treaties and laws of the United States contemplate the Indian territory as completely separated from that of the States; and provide that all intercourse with them shall be carried on exclusively by the government of the Union.
>
> . . . .
>
> The Cherokee nation, then, is a distinct community, occupying its own territory, with boundaries accurately described, in which the laws of Georgia can have no force, and which the citizens of Georgia have no right to enter but with the assent of the Cherokees themselves or in conformity with treaties and with the acts of Congress.

Id.

106. Blue Jacket v. Board of Comm'rs (The Kansas Indians), 72 U.S. (5 Wall.) 737 (1867).

107. *Id.* at 755–57.

108. *Id.* at 755–56.

Exclusive tribal tax jurisdiction was not long-lived. In *The Cherokee Tobacco,*[109] heard only three years after *The Kansas Indians,* the applicable treaty expressly exempted from federal taxes goods made and sold within the Indian Territory. The Supreme Court nevertheless upheld federal taxation of tobacco made and sold within the Indian Territory, reasoning that congressional breach of a treaty stipulation involves a nonjusticiable, political question.[110] The net effect of *The Kansas Indians* and *The Cherokee Tobacco* was to permit federal, but not state, infringements of tribes' independent tax jurisdiction.

B. Phase II: Federal Instrumentalities

In the United States, local revenue has always rested on a foundation of property taxes. Formal legal division of tribal territory into individual holdings under the General Allotment Act[111] after 1887 resulted in a flurry of property tax controversies. Putting Indians on a footing of complete socioeconomic individualism, allotment officially abolished tribal governments; the Supreme Court could no longer justify exemption from state taxation on the basis of tribal sovereignty. The Court was nevertheless persuaded that state taxation of allotments would impoverish Indians struggling to make a start in agriculture and lead to tax foreclosures of allotted lands. In *United States v. Rickert,*[112] the Court concluded that "[t]o tax [allotted] lands is to tax an instrumentality employed by the United States for the benefit and control of this dependent race, and to accomplish beneficent objects . . . . [I]f they may be taxed, then the obligations which the government has assumed in reference to these Indians may be entirely defeated."[113] *Rickert* extended the exemption to the land

109. Two Hundred and Seven Half Pound Papers of Smoking Tobacco v. United States (The Cherokee Tobacco), 78 U.S. (11 Wall.) 616 (1871).

110. *Id.* at 621. Justice Davis, who wrote the opinion in *The Kansas Indians,* joined the dissent in *The Cherokee Tobacco* and would have held the federal tax inapplicable on the Indian territory. *The Cherokee Tobacco,* 78 U.S. (11 Wall.) at 622–24 (Bradley and Davis, JJ., dissenting).

111. Act of Feb. 8, 1887, ch. 119, 24 Stat. 388 (codified as amended at 25 U.S.C §§ 331–381 (1976)).

112. 188 U.S. 432 (1903).

113. *Id.* at 437–38. *See also id.* at 438–39. The *Rickert* Court identified two other sufficient grounds for the tax exemption: the language of the allotment act itself, *id.* at 438, and an express disclaimer of jurisdiction over Indian lands in the state's constitution, *id.* at 440–41. Subsequent decisions relied on *Rickert*'s instrumentality language alone, however. The relevant portion of the General Allotment Act provides that "at the

itself, permanent improvements, and personal property supplied or financed by the United States.[114] The extent of the instrumentality entitled to tax exemption was subject to interpretation in later cases.

Although it upheld Indian tax immunity in the case before it, the *Rickert* Court altered the complexion of reservation tax litigation by implying that state jurisdiction is *to be presumed* absent explicit federal policy to the contrary. Such a presumption was consistent with the Court's belief that allotment was part of a transition to full state control of formerly tribal areas.[115] Since the general object of federal policy was to assimilate Indians into state government, it seemed reasonable not to delay that process without some clear indication of federal intent.[116]

Subsequent decisions at first broadened the range of activities on Indian land which qualified for instrumentality tax exemptions. In *Choctaw, Oklahoma & Gulf Railroad Co. v. Harrison,*[117] the Supreme Court agreed that a non-Indian mineral lessee acted as a federal instrumentality in developing Indian trust lands. Any tax on the value of the lessee's business or otherwise affecting the ability of the lessee to engage in it successfully would be invalid. The Court, moreover, warned states against trying to avoid its ruling by inventing new taxes or giving them new names. "Neither state courts nor legislatures, by giving a tax a particular name, or by the use of some form of words, can take away our duty to consider its real nature and effect."[118] *Choctaw* and the cases that followed it struck down Oklahoma state taxes on lessees' gross production (both in ad valorem and

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expiration of said period the United States will convey the same by patent to said Indian, or his heirs as aforesaid, in fee, discharged of said trust and *free of all charge or incumbrance whatsoever* . . . ." 25 U.S.C. § 348 (1976) (emphasis added).

114. 188 U.S. at 442 (permanent improvements such as houses and other structures on allotted lands), 443–44 (personal property—cattle, horses, and other property—issued to Indians in connection with allotment).

115. *See, e.g.,* Draper v. United States, 164 U.S. 240, 246 (1896).

116. The allotment policy was repudiated by the Indian Reorganization Act in 1934, however. 25 U.S.C. §§ 461–465 (1976). The act re-established reservation boundaries and tribal governing bodies, inconsistent with any presumed state regulatory authority. It should have put an end to *Rickert,* and resurrected pre-*Rickert* theories of tribal sovereignty. But the course of the law was to pay more heed to the economics of oil than to the words of Congress or of treaties. Mineral production from non-Indian leaseholds on Indian lands was a magnetic attraction to state tax administrators in the era of the great Oklahoma oil strikes. For 50 years following *Rickert* nearly all reservation tax cases involved non-Indian lessees; in none was an Indian or Indian tribe directly represented.

117. 235 U.S. 292 (1914).

118. *Id.* at 298.

excise form), property, and income.[119] In *Gillespie v. Oklahoma,*[120] Justice Holmes expressed the instrumentality principle succinctly: no tax is valid if it is "a direct hamper upon the effort of the United States to make the best terms that it can for its wards."[121] In other words, any tax shifted to the Indian allottees is invalid.

Rickert, Choctaw and *Gillespie* narrowly identified the express language and legislative history of the General Allotment Act as the source of Indians' instrumentality tax exemption. Economic analysis was used merely to determine the scope of the exemption in a particular case. In *Helvering v. Mountain Producers Corp.,*[122] however, the Supreme Court misconstrued the basis of Indians' immunity. *Mountain Producers* had nothing to do with Indians and involved federal taxation of a state instrumentality rather than state taxation of a federal instrumentality.[123] A lessee of Wyoming state school lands resisted federal taxation on a theory of *general* intergovernmental tax immunity absent explicit federal protective legislation. Erroneously reading *Gillespie* in support of the lessee's theory, the Supreme Court declared *Gillespie* overruled and held that a tax is not invalid merely because it imposes a "remote" or "theoretical" economic burden on government.[124] The Court subsequently used *Mountain Producers* to strike down the general immunity of federal contractors from state taxation.[125]

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119. Gillespie v. Oklahoma, 257 U.S. 501 (1922); Large Oil Co. v. Howard, 248 U.S. 549 (1918) (per curiam); Howard v. Gipsy Oil Co., 247 U.S. 503 (1917) (three cases, per curiam); Indian Territory Illuminating Oil Co. v. Oklahoma, 240 U.S. 522 (1916).

120. 257 U.S. 501 (1922).

121. *Id.* at 506. The Court in *Gillespie* also declared that if the principal was immune from tax, any income derived from that principal was immune. *Id.* at 505–06.

122. 303 U.S. 376 (1938). When the Court heard *Mountain Producers* in 1938, it was imbued with New Deal concern for "the expanding needs of state and nation" and anxious to dispose of any remaining vestiges of general intergovernmental tax immunities. *See id.* at 384.

123. *Id.* at 383. The alleged instrumentality was a tract of Wyoming state-owned land, the revenue of which was dedicated to financing the state schools. Although in *Mountain Producers* there was no evidence of congressional intent to grant tax immunity and, indeed, the case did not even involve Indian property, the Court overruled *Gillespie*. *Id.* at 387.

124. 303 U.S. at 384, 385–86. *See* note 121 and accompanying text *supra*.

125. Alabama v. King & Boozer, 314 U.S. 1, 8 (1941). A state or local tax exacted from the federal contractor is not invalid "merely because it is passed on economically, by the terms of the contract or otherwise, as a part of the construction cost to the government." *Id.* The federal government unsuccessfully argued that the state tax was invalid because, due to the manner in which it was collected, the legal incidence of the tax was on the federal government. *Id.* at 9.

A decade after *Mountain Producers, Oklahoma Tax Commission v. Texas Co.*[126] tested Oklahoma's reimposition of the gross oil production tax on Indians' lessees struck down in *Choctaw.*[127] Ignoring completely the express language of the General Allotment Act relied on by *Rickert,*[128] the Vinson Court characterized lessees of allotted Indian land as merely private persons performing services for the federal government, indistinguishable from other government contractors,[129] and applied *Mountain Producers'* general repudiation of intergovernmental tax immunities to the instrumentality theory of Indian tax exemption.[130] Justice Rutledge, writing for the Court, characterized the facts in *Mountain Producers* and *Oklahoma Tax Commission* as identical,[131] and, following *Mountain Producers'* burden test, maintained it was unimaginable that such a "small tax" could do any substantial damage to Indian allottees.[132]

Justice Rutledge contended there was "no possibility that ultimate liability for the taxes may fall upon the [Indian] owner of the land."[133] If "burden" is relevant at all, however, the test should be economic incidence rather than legal liability. A tax on business income tends to be shifted to the owners of factors of production (land, labor, and capital) in a competitive setting.[134] Some part of the lessees' tax, therefore, is borne by Indian lessors.[135]

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126. 336 U.S. 342 (1949).

127. *See* notes 117-21 and accompanying text *supra.*

128. 188 U.S. at 438.

129. 336 U.S. at 350, 353-54.

130. *Id.* at 362-65. Quoting *Mountain Producers,* the Court unceremoniously rejected the theories of *Gillespie, Choctaw,* and, by implication, *Rickert. Id.* at 360-61, 364. It also expressly overruled all the oil tax cases. *Id.* at 365.

131. *Id.* at 363.

132. *Id.* at 351.

133. *Id.* at 353. "These cases present no question concerning the immunity of the Indian lands themselves from state taxation. There is no possibility that ultimate liability for the taxes may fall upon the owner of the land." *Id.* This reasoning, which distinguishes taxing the land itself from taxing income directly derived from the land, was, of course, repudiated only seven years later in the federal taxation context in Squire v. Capoeman, 351 U.S. 1 (1956). The Court in *Oklahoma Tax Commission* seems not to have grasped that if the non-Indian lessees' production is taxed, the Indian lessor will receive a smaller royalty, analogous to the effect of federal income taxation on royalties. *Cf.* Rev. Rul. 67-284, 1967-2 C.B. 55, 57 (royalties exempt from federal income taxation).

134. *See* notes 14-24 and accompanying text *supra* (discussion of incidence of various forms of taxation).

135. Justice Rutledge also argued that the state tax in issue would be lawful, even if it were a burden on Indian lessors, as the quid pro quo for the benefits of state regulation. 336 U.S. at 351. Oklahoma's oil production proration scheme at that time may have increased both lessees' and lessors' income by limiting price competition among

However flawed, *Oklahoma Tax Commission* turned the course of Indian law. It ended any widespread application of the instrumentality theory for exempting Indian lands from state tax. Moreover, Justice Rutledge's reliance on the locus of legal liability for payment of the tax introduced a new factor in evaluating state taxation of Indians. The identity of the *legal taxpayer* became more determinative than the *actual incidence* of the state tax.

C. *Phase III: Federal Preemption and Personal Rights*

Contemporary judicial treatment of state taxation of reservation wealth began in a 1958 consumer debt case, *Williams v. Lee*.[136] Writing for a unanimous Court, Justice Black summarized the determinative principle: "Essentially, absent governing Acts of Congress, the question has always been whether the state action infringed on the right of reservation Indians to make their own laws and be ruled by them."[137] The Court looks first for governing acts of Congress which may authorize[138] or limit[139] state power. Absent a determination on that basis, the Court must consider whether state assertions of power infringe upon tribal self-government, as if there is an implicit general federal policy of encouraging Indian home rule.[140]

In *Williams* itself, however, Justice Black confused the issue by using the same facts in applying both tests. Express congressional policy was found in the history of congressional dealings with Indians, in the terms of the applicable treaties and in a provision of the Navajo-Hopi Rehabilitation Act expressly authorizing tribal constitutional self-gov-

oil companies. Most state laws' benefits spill over to neighboring jurisdictions, however. A homeowner in Portland, Oregon, benefits from law enforcement activities in neighboring Washington counties but does not thereby become liable for the payment of Washington taxes.

136. 358 U.S. 217 (1959). *Williams* tested state civil jurisdiction over an action brought by a non-Indian vendor against an Indian purchaser to collect goods sold on the Indian reservation.

137. *Id.* at 220.

138. The Court in *Williams* noted that there was a general statute under which states were authorized, in appropriate circumstances, to assume jurisdiction over reservation Indians, but that Arizona had not acted under the statute. 358 U.S. at 222–23 (citing Public Law 280, Act of Aug. 15, 1953, Pub. L. No. 83-280, 67 Stat. 589, §§ 6–7, *reprinted in* 28 U.S.C. § 1360 notes (1976)). *See also id.* at 221 n.6.

139. *See, e.g.,* notes 141 & 142 and accompanying text *infra.*

140. The source to which the Court looked for the right of reservation Indians to self-government is ambiguous. The Court cited the antecedent tribal sovereignty principle of *Worcester v. Georgia* and *The Kansas Indians*. 358 U.S. at 218–20. But the Court also referred to the conduct of Congress. *Id.* at 220–22.

ernment.[141] The intimation was that congressional policy, especially the Navajo-Hopi Rehabilitation Act, had precluded the area of state jurisdiction over the territory by the tribe, regardless of whether state action in a particular case actually infringed on tribal authority.[142] But Justice Black also argued that state civil jurisdiction is per se an actual infringement of tribal self-government.[143] Thus, it was not clear in *Williams* whether the Indian petitioners' immunity from state law was based on preclusive express congressional enactments or on the actual infringement of an implicit policy.[144] Unfortunately, subsequent cases have construed *Williams* to require *both* express federal recognition of tribal jurisdiction *and* a showing of actual infringement or harm.

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141. The relevant section of the Navajo-Hopi Rehabilitation Act provides in part:

> The members of the tribe shall have the right to adopt a tribal constitution . . . provid[ing] for the exercise by the Navajo Tribe of any powers vested in the tribe . . . by existing law, together with such additional powers as the members of the tribe may, with the approval of the Secretary of the Interior, deem proper to include therein.

25 U.S.C. § 636 (1976). The Indian Reorganization Act contains similar provisions. "Any Indian tribe . . . shall have the right to organize for its common welfare, and may adopt an appropriate constitution and bylaws," including "all powers vested in any Indian tribe . . . by existing law," subject to approval by the Secretary of the Interior. 25 U.S.C. § 476 (1976).

142. For a discussion of the preemption doctrine in Indian law, see D. GETCHES, D. ROSENFELT & C. WILKINSON, FEDERAL INDIAN LAW 295–99 (1979). For discussions of preemption generally, in non-Indian contexts, see Ray v. Atlantic Richfield Co., 435 U.S. 151, 156–57 (1978); Morris, *Constitutional Preemption of State Laws Against Massive Oil Spills,* 1 U. PUGET SOUND L. REV. 73, 83–97 (1977); Note, *The Preemption Doctrine: Shifting Perspectives of Federalism and the Burger Court,* 75 COLUM. L. REV. 623 (1975).

143. 358 U.S. at 223. If this is construed as the infringement of a federal policy, then the conflict variety of preemption is involved. *See* Morris, *supra* note 142, at 84–85. But it may also be portrayed as infringement of antecedent tribal sovereignty.

144. The most plausible interpretation of Justice Black's reasoning is that express federal recognition of antecedent general tribal jurisdiction is equivalent to an express preclusive federal prohibition of state jurisdiction. By recognizing in general terms the authority of a tribe, Congress preempted all state regulation of tribal territory. Read this way, *Williams* finally dealt with the two-decade-old Indian Reorganization Act, which the Court had not referred to since its enactment. This interpretation draws some support from Justice Black's handling of Warren Trading Post Co. v. Arizona State Tax Comm'n, 380 U.S. 685 (1965). The taxpayer was a non-Indian trader on the Navajo reservation. He argued that the federal statute licensing and regulating Indian traders, 25 U.S.C. §§ 261–262 (1976), completely preempted state regulation and taxation of his business, and Justice Black, writing for the Court in *Warren,* agreed. The comprehensive statute and regulations showed "that no room remains for state laws imposing additional burdens upon traders." 380 U.S. at 690. *See also id.* at 691–92. This was so even though federal law does not expressly exempt licensed traders from any local laws or taxes.

Fifteen years later, the Court had an opportunity to apply *Williams* to a tax problem. *McClanahan v. Arizona Tax Commission*[145] involved that state's attempt to tax an individual Navajo's reservation income. Groping for doctrine, the Court offered four entirely independent theories for its holding that McClanahan's income was tax exempt. Without offering any specifics, the Court implied that state income taxation would infringe on Navajo self-government.[146] But the Court also made a great deal of the fact that Congress had shown a clear intent to protect Navajo self-government and had never expressly authorized the Arizona tax—a federal preemption theory.[147]

It was not clear whether the tax was illegitimate because it actually interfered with tribal government or because it was generally preempted by federal recognition of Navajo tribal government.[148] Not yet satisfied, Justice Marshall, for the unanimous Court, observed that Arizona's Enabling Act[149] expressly disclaimed jurisdiction over Indian land. Thus, even if the state tax were harmless and not preempted by federal recognition of the tribal constitution, it would still be void under the law admitting Arizona to the Union.[150] Last, but not least, McClanahan was immune from state taxation because of her personal status as a reservation Indian, apart from the political authority of her tribe.[151] If tax immunity is a personal right, however, it cannot be lost when the taxpayer leaves the reservation, an implication Justice Marshall neglected to discuss.

The decision and opinion in *Moe v. Confederated Salish & Kootenai Tribes*[152] is evidence that *McClanahan*'s personal rights analysis

145. 411 U.S. 164 (1973).

146. *Id.* at 174–75. This reasoning, of course, recalls the tribal sovereignty rationale of *Worcester v. Georgia* and *The Kansas Indians*. *See* notes 104–08 and accompanying text *supra*.

147. 411 U.S. at 176–78.

148. *See* Fisher v. District Court, 424 U.S. 382 (1976) (per curiam). In *Fisher*, exclusive tribal jurisdiction over on-reservation child custody disputes solely among tribe members was justified alternatively on the grounds of infringement of tribal self-government, *id.* at 388, or of complete federal preemption of state jurisdiction through enactment of the Indian Reorganization Act, *id.* at 388–90. The Court seems unable to separate the two parts of *Williams* and follow either one or the other consistently.

149. Act of June 10, 1910, ch. 310, § 20, 36 Stat. 557, 569–570.

150. 411 U.S. at 175.

151. *Id.* at 181. This personal immunity argument was a refinement of the tribal sovereignty and federal preemption arguments. The Court was required to make it because Arizona had argued that since the income tax was a personal tax on individual Indians, not a tax on Indian lands or a tax on Indian business operations, it did not "infringe" on tribal self-government or contravene federal policies protecting tribes. *See id.* at 166–67.

152. 425 U.S. 463 (1976). *See generally* Barsh, *supra* note 103.

has captured the Court's imagination. Montana tried to impose its cigarette excise tax on sales by Indian vendors on the reservation to Indian and non-Indian consumers. A three-judge district court upheld the imposition of the tax on non-Indian consumers, and the Supreme Court agreed.[153] According to Justice Rehnquist, writing for a unanimous Court, Montana state law, which defined the consumer purchaser as the legal taxpayer, was conclusive as to the economic incidence of the tax.[154] Under state law, the tax was borne by the retail purchaser; vendors merely "precollected" it by adding it to the sales price. A tax paid by non-Indians could neither infringe on the personal rights of Indians nor harm the tribe because Indians did not bear the tax.[155]

The actual economic burden of Montana's cigarette tax is not settled so neatly, however. Depending on the price inelasticity of demand for cigarettes, a tax on cigarette sales will be borne in some part by vendors.[156] *Moe* permits states to tax Indian businesses indirectly by taxing their sales to non-Indians. Justice Rehnquist's opinion conceded that Indian vendors probably would lose net income on sales, but deemed that immaterial. "Since nonpayment of the tax is a misdemeanor as to the retail purchaser, the competitive advantage which the Indian seller doing business on tribal land enjoys . . . is dependent on the extent to which the non-Indian purchaser is willing to flout *his* legal obligation to pay the tax."[157]

This is equivalent to saying that it is legal to tax the sale because it is legal to tax the sale. The question in the case should be *whether* Montana may tax non-Indian purchases from Indian sellers. Montana's tax is questionable under federal law because it causes economic loss to the Indian seller just as a tax directly on Indians. It therefore is circular to disregard the economic loss on the assumption

153. 425 U.S. at 481–83. The Court did hold, however, that the cigarette tax on sales by Indian vendors to Indian purchasers, a state license fee for vendors, and a personal property tax on property within the reservation were all inapplicable to reservation Indians. *Id.* at 480–81.

154. *Id.* at 481–82. The Court thus reversed the position on interpreting state tax laws and the impact of their burdens which it had expressed in *Choctaw*. *See* notes 117 & 118 and accompanying text *supra*.

155. Just as the burden imposed on Indian sellers by requiring them to collect the tax "is not, strictly speaking, a tax at all" and hence is permissible, 425 U.S. at 483, so the net business loss of Indian income due to the imposition of the tax is not "strictly speaking" a tax. *But see* note 5 and accompanying text *supra* (broader definition of "tax").

156. *See* notes 20–22 and accompanying text *supra* (tax shifting as function of price elasticity).

157. 425 U.S. at 482 (emphasis in original).

that Montana legally can impose it on Indians.[158] Under *Moe,* moreover, the state can use the Indian vendor as an involuntary agent in collecting the tax from non-Indians and make the vendor liable for prepayment without infringing upon Indians' personal tax immunity.[159]

If the Court's analysis in *Moe* seems confusing, consider that in *Bryan v. Itasca County,*[160] decided little more than a month after *Moe* by another unanimous Court, Justice Brennan declared that the proper rule in cases challenging state taxation of Indians had always been federal preemption. No mention was made of infringement of tribal self-government, of reservation Indians' personal rights, or of the identity of the legal taxpayer. The relevant issue, according to *Bryan,* was the presence or absence of clear congressional consent to the state tax.[161]

Bryan may not have been as much of a departure as it seems on first impression. The court below held that the state lacked power to tax Bryan's property absent congressional statutory authorization,[162] limiting the Supreme Court's freedom to discuss alternative theories of state power. Furthermore, the facts in *Bryan* fulfilled both the personal rights and legal taxpayer standards of *McClanahan* and *Moe*[163]

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158. Justice Rehnquist may have had in mind non-Indians' obligation to pay a compensating state use tax upon re-entering state territory in possession of untaxed goods. However, the fact that a state citizen may fail to pay his own state's compensating use tax upon re-entry has never been sufficient by itself to permit his state of residence to follow him into the territory of the state of purchase. A state's tax collection procedure may reach outside of state territory only to businesses that have "some definite link" with the taxing state. National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756–57 (1967) (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954)). *See also* National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551, 560–61 (1977).

159. 425 U.S. at 482–83. *See* note 155 *supra.*

160. 426 U.S. 373 (1976). Bryan, a tribal Indian residing on the reservation, challenged the power of the county to assess a personal property tax on his mobile home located on reservation trust land. The case would have been resolved simply, perhaps by reference to *Rickert, see* notes 114 & 115 and accompanying text *supra,* but for the fact that Minnesota had assumed civil and criminal jurisdiction over Bryan's reservation in accordance with Public Law 280. 18 U.S.C. § 1162, 28 U.S.C. § 1360 (1976). *See generally* Comment, *Washington's Public Law 280 Jurisdiction On Indian Reservations,* 53 WASH. L. REV. 701 (1978). Public Law 280 required some states, and authorized others, to assume general civil and criminal trial jurisdiction over tribal areas. In *Bryan* Minnesota argued that this included congressional authorization of state taxation in tribal areas, but the Court vigorously denied that interpretation of the statute. 426 U.S. at 381–93.

161. 426 U.S. at 376–77, 376 n.2.

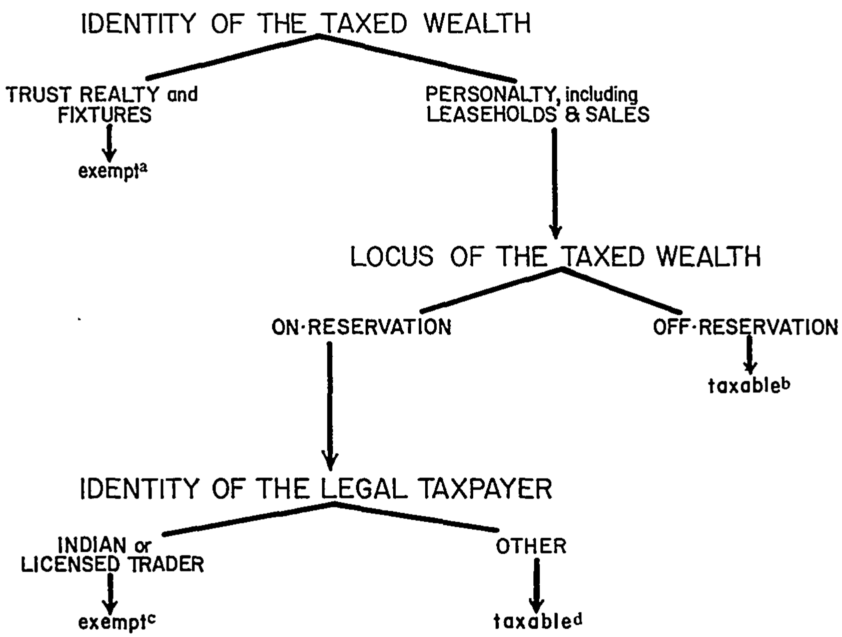
162. *Id.* at 378.

163. The legal taxpayer in *Bryan* was a reservation Indian; the tax was levied against property owned by a reservation Indian and located on the reservation. *Id.* at 375.

even though the Court did not discuss them. The *Bryan* Court did discuss federal preemption as if it were applicable in all Indian tax cases, although it might have led to a different result in *Moe*. Consequently, it is still not clear what the Supreme Court's standards in state-Indian tax cases will be in the future.

Nevertheless, it is possible to suggest a general model that incorporates all of the recent decisions without inconsistency. Figure 3 is the most parsimonious decision tree that predicts all Supreme Court results since *Oklahoma Tax Commission*. The identity of the legal taxpayer seems to be the principal criterion, followed in importance by the location of the taxed incident.

FIGURE 3
A GENERALIZATION OF STATE TAXATION AFTER *MOE*



a. Mescalero Apache Tribe v. Jones, 411 U.S. 145 (1973). *See also* Bryan v. Itasca County, 426 U.S. 373 (1976).
b. Mescalero Apache Tribe v. Jones, 411 U.S. 145 (1973).
c. Bryan v. Itasca County, 426 U.S. 373 (1976) (Indian); McClanahan v. Arizona Tax Comm'n, 411 U.S. 164 (1973) (Indian); Warren Trading Post v. Arizona Tax Comm'n, 380 U.S. 685 (1965) (licensed trader).
d. Moe v. Confederated Salish & Kootenai Tribes, 425 U.S. 463 (1976).

D. *Future Developments: A New Doctrine of Tribal Preemption?*

In *Confederated Tribes of the Colville Indian Reservation v. Washington,*[164] a three-judge district court held that Washington's cigarette excise tax could not be applied to Indian vendors' reservation sales to non-Indians,[165] despite the contrary result apparently required by *Moe*. Reading state laws and decisions, the court agreed with Washington that purchasers bear the legal incidence of the cigarette tax.[166] Standing by itself, then, the state tax would have been valid under *Moe* as applied to non-Indian purchasers. In fact, however, it was being levied in addition to tribal taxes.[167] The court concluded that under such circumstances state taxation had been preempted by the enactment of tribal tax ordinances and caused actual interference with tribal self-government.[168] Recognition of the authority of tribal legislation suggests a new, preemption version of the tribal sov-

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164. 446 F. Supp. 1339 (E.D. Wash. 1978) (three-judge court), *appeal docketed,* No. 76-630 (S. Ct. Oct. 13, 1978), *consideration of jurisdiction postponed to hearing on merits,* 99 S. Ct. 1210 (1979).

165. 446 F. Supp. at 1362. *But see* Ute Indian Tribe v. Utah State Tax Comm'n, 574 F.2d 1007 (10th Cir.), *cert. denied,* 99 S. Ct. 452 (1978). In *Ute* the tribe sought to have Utah's state sales tax declared inapplicable to all sales by tribal vendors on the reservation and to have taxes previously paid refunded. The Tenth Circuit, following *Moe,* held that sales to non-Indians were subject to the tax, basing its holding on the legal incidence of the tax under Utah law. *Id.* at 1009. *See also* Department of Revenue v. Hane Constr. Co., 115 Ariz. 243, 564 P.2d 932 (Ariz. App. 1977). *Hane* upheld the application of Arizona's transaction privilege tax to an out-of-state, non-Indian construction contractor doing work for the Bureau of Indian Affairs on the Colorado River Reservation. The court observed that federal regulations dealing with government contractors did not forbid the state tax. The court also noted that tribal self-government was not affected, because the contract was with the Bureau, not the tribe, and no tribal funds were involved. *Id.* at 934. Finally, the tax was not on Indian income, property, or lands, because under Arizona law the tax is on "the contractor and cannot legally be shifted to anyone else." *Id.* at 934. Even if the tax could be shifted, it would be shifted to the Bureau and federal government, and only remotely to the Indian tribe. *Id.* The court also supported this analysis by noting that in the case Hane in fact had borne the economic burden, absorbed the loss and not passed it on to the government. *Id.* According to the agreed facts, however, Hane appears to have computed its bid under the assumption that its reservation activities would be tax-exempt and was only advised by state authorities to pay the tax after its contract had been executed. *See id.* at 933.

166. 446 F. Supp. at 1352–55.

167. *Id.* at 1347, 1369.

168. *Id.* at 1360–62 (preemption), 1362–64 (tribal self-government). One judge dissented on the cigarette tax issue and would have held the tax on cigarette sales to non-Indians valid under *Moe* despite the majority's reliance on tribal tax measures. *Id.* at 1374–75 (Kilkenny, J., concurring and dissenting).

ereignty doctrine of earlier days.[169] The Supreme Court has agreed to hear *Colville;*[170] some reconciliation with *Moe* should be forthcoming.

Essential to the court's reasoning in *Colville* was its determination that tribal tax revenues would be reduced substantially if the state tax was upheld.[171] "[W]ith regard to a commodity as highly price elastic as cigarettes, the result [of the added state tax] will be the depletion of an already limited tax base."[172] Actual loss of tribal tax revenue

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169. *See* notes 106-10 and accompanying text *supra.* The court, moreover, made a great effort to explain the *Williams* test and to minimize the impact of *Mountain Producers.* 446 F. Supp. at 1362-63. *See* notes 136-44 and accompanying text *supra (Williams),* notes 122-26 and accompanying text *supra (Mountain Producers).*

170. 99 S. Ct. 1210 (1979).

171. In its preemption reasoning, the court determined that the tribal cigarette marketing, regulating, and taxing ordinance was a valid exercise of its congressionally-delegated power, that the tribal measures and state tax covered the same subject matter, and, most important, that the state tax would be an obstacle to the accomplishment of the purpose of the tribal ordinance. 446 F. Supp. at 1360-61. The tribe's purpose was to raise revenues to fund various essential tribal governmental programs; the state tax would frustrate that purpose by severely lowering tribal revenues. *Id.* at 1361-62. Similarly, in its tribal self-government reasoning, the court relied on the economic impact of state tax. Reductions in tribal tax revenues would lead to curtailment of tribal governmental programs, thus, there was interference with the tribe's self-government. *Id.* at 1362-63.

Colville described as "delegated" rather than retained all tribal powers not taken away by Congress, treating the delegation itself as insufficient to preempt state power. *Id.* at 1361. However, in Fisher v. District Court, 424 U.S. 382, 390 (1976), the Supreme Court suggested that the Indian Reorganization Act had generally preempted state power over subjects included in tribal constitutions.

172. 446 F. Supp. at 1362. The court earlier discussed price elasticity of demand. *Id.* at 1347 n.5. If the quoted statement is true, double taxation must reduce individual Indian vendors' incomes.

Another approach to the problem of distinguishing between legal and economic tax incidence was taken by the Ninth Circuit in Fort Mojave Tribe v. San Bernardino County, 543 F.2d 1255 (9th Cir. 1976). The tribe sought relief from a California possessory interest tax on non-Indian lessees of tribal land. The lease rental was a source of tribal revenue. At first, the court recognized the possibility of tax shifting by non-Indian lessees to the tribal lessor:

> The economic, as opposed to the legal incidence of the tax is uncertain. . . . In this case, we proceed on the assumption that it is *possible* for the economic burden of the tax, in whole or in part, to fall on the Indians. We do not know whether it is *probable* that it will do so.

Id. at 1255 n.2 (emphasis in original). Rather than place the burden of resolving the uncertainty over tax shifting on one of the parties, the court proceeded to dismiss the economic impact of the state tax on Indians as "indirect" and "minimal" for infringement purposes. *Id.* at 1258. The court also deemed the tax burden on Indians to be too small to be invalid absent express congressional authorization, as would be required by *McClanahan* and *Moe.* "The maxim [that ambiguous statutes should be construed to benefit Indians] was never intended to authorize constructions which, on their face, should not have been necessary to support the decision. The tribes have a governmental interest in regulating reservation businesses operated by tribal members,[173] whether or not they choose to tax them for revenue or for other governmental purposes. It should be sufficient for preemption that the tribe has a business regulation ordinance occupying the field. All vendors in *Colville* were tribally licensed and regulated.[174]

Unfortunately, the *Colville* opinion makes it clear that a tribe can protect reservation business from state taxation only by imposing a tax system itself.[175] Tribes can easily enact business taxes and thereby preempt state tax jurisdiction. But any tax collection scheme involves administrative expenses; to oust a state tax, the tribe must bear that expense. Moreover, *Colville* emphasized the tribal government programs funded with tax revenues. If tribal revenues and expenditures, rather than the existence of a tribal tax ordinance, are the key determinants of preemption, then *Colville* may rule out tribal schemes to stimulate business enterprise through the use of tax shelters.

The *Colville* court was cognizant of the plaintiff tribes' poverty and underdevelopment and obviously was concerned about the effect of state taxation on the tribes' ability to raise public funds. Nevertheless, its decision may deny tribes one of their only tools of economic stimulus. Capital-poor, thinly populated, and short on transportation and communications infrastructure, tribes can do little to attract new business ventures other than to create local regulatory and tax advantages. In this sense *Colville* is an incomplete victory for tribes even if its reasoning is sustained by the Supreme Court.

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benefit non-Indians handsomely and Indians only marginally, if at all." *Id.* at 1257. The court assumed, without measurement, that little state tax actually would be shifted to lessors.

Fort Mojave resolved all doubt over tax shifting against the tribe. The court explained this as required by the "state's recognized authority to regulate its citizens." *Id.* The Fort Mojave reservation lies at the conjunction of Arizona, California and Nevada, and there was no evidence that the taxed lessees were all or mostly Californians. In effect, then, California claimed and won the power to tax all non-Indian lessees of Fort Mojave land within California's boundaries.

173. *Cf.* Williams v. Lee, 358 U.S. 217 (1959) (tribal interest in adjudicating reservation consumer debt cases); Fisher v. District Court, 424 U.S. 382 (1976) (tribal interest in sole jurisdiction of adoption proceedings involving tribal members).

174. 446 F. Supp. at 1347–48.

175. "[T]here is no preeemption absent tribal taxation." *Id.* at 1362. *See also id.* at 1364 (distinguishing *Moe* by saying that the tribe in *Moe* received no direct benefit from reservation cigarette sales because it did not tax them nor was it otherwise directly involved).

V. ALTERNATIVES FOR STATE AND TRIBAL TAX DISPUTES

A. Continued Litigation

Continued reservation economic growth, increasing state and local revenue needs, and case law ambiguity make relitigation of the issues in *Moe* and *Colville* likely. States will probably try to protect their revenue by changing the identity of the legal taxpayer and tribes will probably respond by legislating more "preemptive" tribal taxes. If *Colville* becomes established law, both the legal incidence and the actual direct effect on tribal revenue of each state tax will be fresh issues in each suit. Moreover, *Colville* itself leaves many questions, including the tax status of Indians not members of the reservation tribe,[176] the extent of permissible state record-keeping and collection procedures,[177] and burden of proof requirements in contested tax

176. Washington's "Rule 192" was one target of the *Colville* suit, but many of the rule's theories survived the decision. *See* WASH. ADMIN. CODE § 458-20-192 (1977) (adopted November 1976, shortly after *Moe*). For example, for tax liability purposes it defines "Indian" as a person "duly registered on the tribal rolls of the Indian tribe upon and within whose Indian reservation [the] transaction or activity occurs." *Id.* According to this, if a Flathead is living with his Suquamish wife on the Port Madison reservation with her relatives, she is exempt but he is not. The enforcement of this condition would reduce the number of reservation Indians entitled to exemptions, but it also would have the effect of taxing intertribal marriages. *Moe* had reserved decision on these problems. 425 U.S. at 480-81 n.16.

Because the *Colville* court held that the state cigarette tax was inapplicable to reservation sales to all nontribal members, Indian or not, it did not reach the issue of the definition of Indian for the cigarette tax. For applications of the general sales tax in the connected case, however, it did reach the issue and held that "all Indians residing on a reservation are equally free from the State's excise taxation regardless of whether they are members of the tribe." 446 F. Supp. at 1371-72.

177. In the context of cigarette sales to exempt Indian purchasers, *Colville* concluded that Rule 192's procedures for collecting sales taxes from vendors were unlawfully burdensome, but did not indicate whether any other state collection procedures might be permissible. 446 F. Supp. at 1359. Washington required precollection of state sales taxes from all but persons "personally known to the retailer" as enrolled tribal members and persons bearing official tribal indentity cards. Each exempt sale was to be documented with a record of the purchaser's name, tribal affiliation, and date. The *Colville* court correctly reasoned that the required recordkeeping on tax-exempt sales imposed business costs on vendors which they could avoid only by ceasing to do business with both Indians and non-Indians or minimize by collecting the state tax on all sales. *Id.* (ceasing to do business).

Later, however, in the general sales tax context, the court said that precollection and recordkeeping on taxable transactions were permissible as reasonably necessary to ensure payment of the taxes, despite the fact that a similar cost-imposing burden was created. *Id.* at 1373. Moreover, the court implied that the recordkeeping on nontaxable Indian transactions would be permissible if the state could meet its burden to show such records were reasonably related to collection of taxes in taxable transactions. *Id.* Clearly, the scope of permissible collection procedures is far from settled.

collections.[178]

Although the vendors in *Colville* were all Indians operating under tribal licenses, the operative fact was the anticipated effect of state tax collections on tribal tax revenues. Tribal tax revenues are no less affected by state taxation of tribally-taxed non-Indian reservation businesses. If tribal power to tax these non-Indian enterprises flows from the same sources as tribal power to tax reservation Indians,[179] the identity of the tribal taxpayer, by *Colville's* reasoning, should be immaterial, as long as tribal revenues are impaired by state taxation. In view of the degree of "foreign" (off-reservation, non-Indian) capital invested in reservation industry, especially on the energy-rich Rocky Mountain reservations, this subject will prove fertile ground for new litigation.

It is in the nature of the judicial process that decisions are not comprehensive, but rather are limited to the facts at hand and to the juris-

178. Even after *Colville* a state may require precollection of state taxes by Indian vendors in the absence of a preemptive tribal tax. In such cases will Indian vendors bear the burden of proving the identity and tax-exempt status of past customers in a state action for back taxes? Will Indian vendors have a good faith defense against state charges that taxes were wrongfully not collected from certain purchasers? Even if the state bears the burden of proof, it has the resources to put small-scale Indian vendors out of business by systematically challenging all of their tax-exempt sales and putting them to a costly legal defense. The state ordinarily would bear the burden of proof as criminal prosecutor or civil plaintiff, but probably would be able to make a prima facie case simply by showing that some recorded purchasers are not enrolled members of the vendor's tribe.

179. *See* Oglala Sioux Tribe v. Barta, 146 F. Supp. 917 (D.S.D. 1956) (in case involving tribal tax levied on non-members leasing tribal land, tribal tax powers described as inherent and recognized by the Indian Reorganization Act). Power to tax is enumerated in 119 tribal constitutions, and is either unrestricted or expressly made applicable to non-Indians in 112, or 94%, of them. Non-Indians are made expressly immune from tribal taxation in only five tribal constitutions. Computed by author from a reading of tribal constitutions collected in G. FAY, CHARTERS, CONSTITUTIONS AND BY-LAWS OF THE INDIAN TRIBES OF NORTH AMERICA (Museum of Anthropology, Univ. of N. Colo., Occasional Publications in Anthropology, Ethnology Series No. 1-16, 1967-1972). After Oliphant v. Suquamish Tribe, 435 U.S. 191 (1978), it may be asked whether tribal taxation of non-Indians, like tribal criminal prosecution of non-Indians, will be deemed "inconsistent with their status" as Indian tribes. *Id.* at 208 (1978) (quoting Oliphant v. Schlie, 544 F.2d 1007, 1009 (9th Cir. 1976)). The difference is that tribal power to tax non-Indians was generally recognized by the courts prior to the enactment of the Indian Reorganization Act. *See, e.g.*, Buster v. Wright, 135 F. 947 (8th Cir. 1905), *appeal dismissed*, 203 U.S. 599 (1906); F. COHEN, HANDBOOK OF FEDERAL INDIAN LAW 142-43 (1942). It therefore falls within the language of the Reorganization Act, which authorizes tribes to exercise all powers of self-government "vested . . . by existing law." 25 U.S.C. § 476 (1976). *See* 55 Interior Dec. 14 (1934) (Interior Solicitor Nathan Margold's discussion of existing tribal powers, given to aid in interpreting statute).

diction of the court. Decisions are also reversible. A definite and consistent scheme of regulation is difficult, if not impossible, to achieve. Uncertainty over tax liabilities imposes risk and, therefore, cost on reservation businesses. The very lack of closure in Indian law tax operates as a tax on reservation economic development. Accordingly, litigation is not the best means to resolve overall tax policy.

B. *Contractual Resolutions*

1. *Tax-collection compacts*

A largely unexplored avenue of resolution is the use of tribal-state revenue compacts. Such an arrangement was made several years ago between the Oglala Sioux Tribe and the state of South Dakota. The state agreed to collect its 4% retail sales tax on all reservation transactions, then remit 83% of the yield to the tribe.[180] The 83% figure repesented a negotiated estimate of the proportion of total sales attributable to Indian purchasers. Based on recent census figures, the population of the Pine Ridge reservation is approximately 70% Indian,[181] so the ratio agreed to by the state and tribe assumes some greater proportion of income is spent on the reservation by Indians than non-Indians.

The Oglala arrangement simplifies administration, reduces enforcement costs, and minimizes the risk of unexpected tax liability and litigation for vendors. This is an indisputable benefit. On the minus side, parity of reservation and off-reservation tax rates deprives the tribe of power to control tax incidence and thereby shelter certain kinds of retail businesses or subsidize the purchase and consumption of certain goods. The Oglala formula, moreover, generates only about as much tribal revenue as the tribe could have expected had it levied a tax at the state rate on Indians alone. The tribe could have levied a tax on non-Indians as well, increasing its yield. In addition, the Oglala formula compensates each government in proportion to its citi-

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180. *See* Western State Tax Administrators, Indian Taxing Jurisdiction Questions for the Western States 9, attachment C (Sept. 29, 1976) (statement to American Indian Policy Review Comm'n summarizing Oglala Sioux compact) (copy on file with *Washington Law Review*).

181. Bureau of the Census, 1970 Census of Population: Subject Report: American Indians 155 (1973); Bureau of the Census, 1970 Census of Population: South Dakota 43-16 to 43-25 (1973).

zens' spending rather than its public expenditures. If the government with fewer but poorer citizens puts out relatively greater per capita service effort, it will experience a net fiscal loss in the bargain.

An alternative method for revenue contracting is to base the allocation formula on relative revenue needs. Since the tribe may finance a significant share of reservation services for both Indians and non-Indians, a formula permitting the state to retain reservation tax revenue only in proportion to its share of total nonfederally financed reservation services might be more equitable.

2. *Service compacts*

Tax-collection compacts freeze the tribe into the state's tax structure and the incidence pattern associated with it, sacrificing tribal control and policy flexibility.[182] The state could instead assure compensation for reservation service costs without imposing its particular tax scheme on tribes through requisition. An agreement could govern the measurement of state service costs on an annual basis.[183] Each fiscal year the tribe would raise revenue to offset those costs in its own way, through its own tax structure, and remit to the state the amount needed to pay for that year's state services.[184]

Through requisition the taxing government loses no regulatory authority and the servicing government can be compensated completely. However, administrative waste is inherent in such a system of concurrent independent taxation.

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182. The tribal flexibility which will be lost includes not only the basic decisions whether to tax and what to tax, but also the possibility of taxing in addition to state taxes. With regard to the latter, impact on tribal options is determined by whether the agreement limits additional tribal taxes and whether the reservation tax base can sustain tribal taxes in excess of state rates.

183. Congress may intend, however implicitly, that states bear a portion of the cost of state services on reservations in lieu of federal taxation of states to finance federal services. Presumably a requisition formula could take this into account, but it raises an interesting question whether the United States must be party to the agreement.

184. Such a scheme was once recommended as a compromise to resolve the American colonies' tax grievances with the Crown two centuries ago. J. MacPherson, The Rights of Great Britain Asserted Against the Claims of America: Being an Answer to the Declaration of the General Congress 52 (London 1776). It was rejected by the Continental Congress only in the fear that the colonies would be encouraged to bid against one another in the determination of their respective shares of total Continental revenue needs. In the tribal situation this objection disappears.

C. *Federal Legislative Resolution*

All the case law reviewed in this article arose because of the uncertainty of federal legislation. Clarifying legislation would alter the current picture dramatically. Congress could make tribal tax authority exclusive in certain subject matter areas or throughout tribal territory, further qualify tribal tax authority, or qualify or limit state tax jurisdiction on reservations. Under the circumstances, political considerations may be expected to prevail over sound policy: votes will outweigh measurable economic benefits. The recent strong "white backlash" against tribal government and the small number of Indian voters may explain why tribes have been reluctant to press for federal tax legislation.[185] Any federal legislation regarding state and tribal taxation must consider the following factors if it is to be economically rational.

1. *Accurate measurement of state costs*

New federal Indian tax law should respond intelligently to the economic realities of tribal and state competition for tax resources. The primary force behind state efforts to tax reservations is concern for state costs of serving reservation residents. Four measurements must be made to determine correctly the state's actual net costs:

(1) State share of reservation expenditures. Excluding all federal formula and project assistance, how many state dollars are actually expended within the reservation? After deduction of the federal share, this cost is far less impressive than a cursory reading of state budgets suggests. A major portion of the cost of public assistance and other Social Security Act programs is federally financed.[186] In addition, Indians qualify for a number of special federal funding programs, many of which are administered by the states.[187]

185. *Cf.* H.R. 9054 (proposal to terminate all tribal governments outright), H.R. 9950 (proposal to limit tribal authority to regulation of Indians), 95th Cong., 1st Sess. (1977). *But cf.* S. 2362, 94th Cong., 1st Sess. (1975) (proposal to forbid state taxation of reservation business where tribe levied comparable tax).

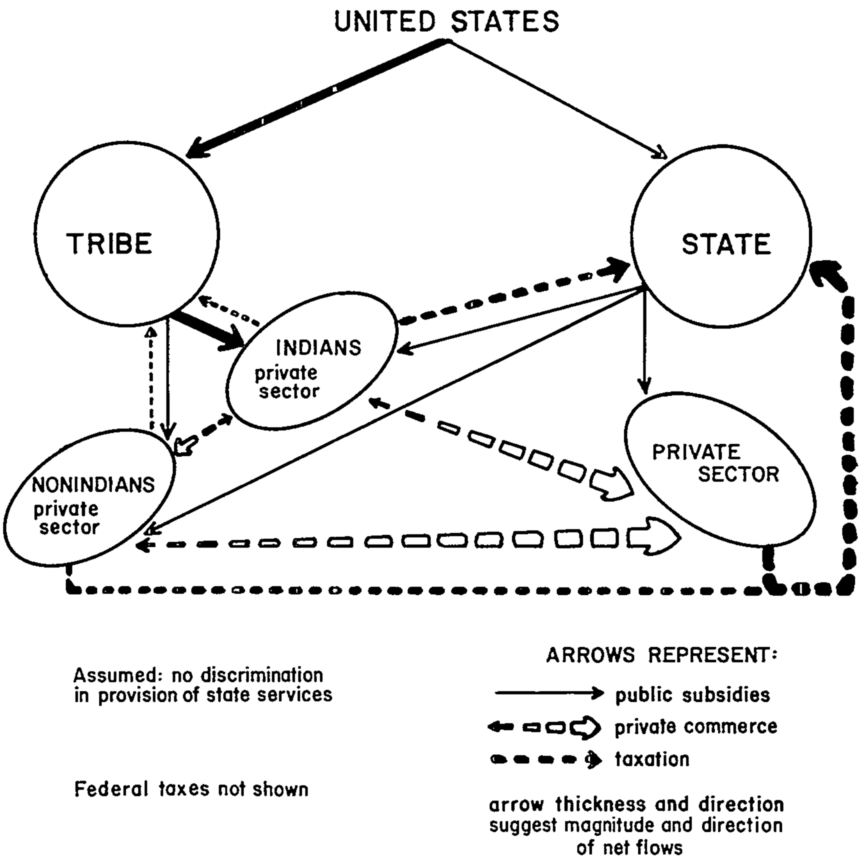
186. *See, e.g.*, 42 U.S.C. §§ 303 (old-age assistance), 502 (unemployment compensation), 603 (aid to families with dependent children), 622 (child-welfare services), 703 (maternal and child health services), 803 (services for aged, blind, or disabled), 1203 (aid to the blind), 1353 (aid to disabled), 1396 (medical assistance programs) (1976).

187. *See, e.g.*, 20 U.S.C. §§ 236–245, 631–647 (impact aid for education), 880b (bilingual education) (1976); 25 U.S.C. §§ 455–458e (Indian Self-Determination and Education Assistance Act education grants) (1976). *See generally Federal Domestic Assistance Programs: Hearing Before the Senate Select Committee on Indian Affairs*, 95th Cong., 1st Sess. (1977).

(2) State share of direct reservation taxes. Fee lands and non-Indians' activities are taxed directly by state and local governments.[188] In addition, many states collect motor vehicle license taxes and motor fuel taxes from both reservation Indians and non-Indians. Whether or not such taxes are beyond legal challenge, they are sources of compensating revenue to the states.

(3) Indirect taxes. As illustrated in Figure 4, reservation residents tend to dispose of most of their income off-reservation because of se-

FIGURE 4
A SIMPLIFIED MODEL OF RESERVATION FLOWS OF FUNDS



188. *See* 25 U.S.C. § 349 (1976) (Indian allottees' land subject to taxation when held in fee); Moe v. Confederated Salish & Kootenai Tribes, 425 U.S. 463, 481–83 (1976) (cigarette tax on sales to non-Indians valid). *See generally* Note, *State Taxation on Indian Reservations*, 1966 UTAH L. REV. 132.

verely limited retail business development and poor investment opportunities at home. As a result, there is a considerable net flow of reservation consumer dollars into the state. In addition, intense federal funding of tribal government planning and public works results in accelerated employment of off-reservation non-Indian contractors and professionals such as planners, lawyers, and engineers. Reservation underdevelopment places the surrounding states in a very favorable balance-of-trade position, with a heavy inflow to the reservation of state goods, labor, and technology, and a heavy outflow to the state's private economy of reservation dollars.

Each net dollar the reservation adds to the state economy recirculates, adding several dollars to the state's wealth. Each circulation also adds to the state's tax base and tax revenues. Depending on the state's economic structure, an appropriate mathematical "multiplier" can be constructed to estimate the magnitude of these effects.[189] Tax revenue from this source is as much revenue collected from reservation output as tax revenue from direct reservation taxes.[190]

(4) Reservation tax revenue potential. This amount represents the total state yield if it could tax reservation residents at parity with off-reservation residents. The computation of this amount requires careful consideration. Most reservations are islands of poverty and represent far less per capita income, per capita consumption, and per capita (or per acre) property valuation than surrounding state territory.

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189. For a general discussion of multipliers see R. MUSGRAVE & P. MUSGRAVE, *supra* note 13, at 504–07. Basic variables in a multiplier are the jurisdiction's effective tax rates, actual savings rates of income-earners, transactions costs, and level of imports and exports with other jurisdictions. In each transaction, the dollar's contribution to total output is eaten up or "drained" by taxes and transactions costs, payees' tendency to save rather than spend the funds again, and the probability that payees will be foreign. For an interesting application of multiplier analysis to estimate the output effects of federal spending on reservations see C. Kent & J. Johnson, Flows of Funds on the Yankton Sioux Indian Reservation, (Ninth District Federal Reserve Bank Information Series 1976) (copy on file with *Washington Law Review), results summarized in* D. GETCHES, D. ROSENFELT & C. WILKINSON, *supra* note 142, at 442.

190. Obviously, Indians buying goods off-reservation pay state sales and excise taxes directly. Limiting the analysis only to these direct off-reservation taxes, however, greatly underestimates the reservation's contribution to state revenues. Suppose, for example, that state consumers save only 20% of their income, the average effective rate of state and federal taxes is 20%, and there is a net import of goods of 10%. Using a simple multiplier limited to these variables (ignoring money supply and transactions cost effects), these factors predict that every dollar added to the state economy contributes $6.90 to the state's gross product. Each dollar circulating in the state's economy which is attributable to the reservation (which would not be present but for the reservation) becomes part of the "indirect tax base." State tax revenues derived from this base, less state expenditures attributable to the transactions in this base, are the state's net indirect tax benefit from the reservation.

In Washington state, for example, 30% of reservation Indian families are below the poverty level, compared with 9% of all families in that state.[191] Figure 5 compares the reservation populations of five states in terms of relative poverty and tax potential.

The net current cost of a reservation to a state is the state's share of reservation expenditures less direct and indirect taxes. The measure of state fiscal *loss*, however, is reservation tax potential, *up to but not exceeding* its cost. There is no policy reason why the state should be able to overcompensate itself by taxing reservations over cost, in light of the pressing economic needs of the reservation. Similarly, if state cost exceeds reservation tax potential, the state could not expect to be fully compensated even if the reservation were "terminated" and became an ordinary county. At tax parity the reservation simply could not pay its way. In every state poorer districts enjoy more state expenditures than they can pay for. On the basis of data currently available, it is impossible to estimate confidently the extent of state losses so measured. Figure 5 compares estimated state expenditures and reservation tax potential for five states, relying on a number of simplifying assumptions. Without measurement of direct and indirect taxes such comparisons are inconclusive.

2. *Federal policies for allocation of state costs*

A rational federal program for reconciling state and tribal tax administration on a burden theory would begin by estimating state losses more precisely. It would then determine what proportion, if any, of these losses the United States will require states to bear in lieu of federal taxes for the support of tribes. All wealthy states now bear higher federal taxes to support federal programs in poor states; there is a net interstate redistribution of wealth inherent in our national tax system. Congress could, but does not now, simply require wealthy states to serve neighboring low-income areas of poor states. The net economic effect would be about the same, although the total administrative cost of such a system might exceed the cost of a single national tax and welfare program, and there would be local variations in the kinds and quality of services rendered. Requiring the surrounding state to bear all or part of its losses in serving the neighboring reservation would be similar.

191. Bureau of the Census, 1970 Census of Population: Subject Report: American Indians 128 (1973); Bureau of the Census, 1970 Census of Population: Washington 49-60 to 49-61 (1973).

FIGURE 5
COMPARATIVE RESERVATION TAX POTENTIAL AND SOME SELECTED STATE EXPENDITURES, 1975[a]

Type of tax potential/ state expenditure		Arizona	Montana	New Mexico	South Dakota	Washington
INCOME TAX POTENTIAL OF RESERVATIONS						
Tribal[b] families as a percent of all families		3.0	2.0	4.0	2.0	1.0
Tribal families' income as a percent of all income		2.4	1.5	0.8	1.7	0.3
Tribal income tax potential ($ millions)[c]	$	1.1	0.2	0.1	-	-
PROPERTY TAX POTENTIAL OF RESERVATIONS						
Reservation nontrust land as per cent of state area		1.0	3.0	0.5	4.0	3.0
Estimated state tax collected on reservation nontrust land ($ millions)[d]	$	6.5	24.8	0.5	7.8	21.5
Reservation trust land as per cent of state area		33.0	6.0	4.0	10.0	5.0
Estimated tax potential of trust land ($ millions)[3]	$	214.0	49.5	4.2	19.4	35.8
SALES TAXES AND TAX POTENTIAL, TRIBAL FAMILIES						
Average state sales tax burden per $1000 income	$	90.0	27.0	103.0	72.0	95.0
Estimated state tax collected by off-reservation merchants from tribal families ($ millions)[e]	$	8.9	0.6	1.6	1.6	2.1
Estimated tax potential of on-reservations sales to tribal families ($ millions)	$	1.4	0.1	0.3	0.3	0.3
SUMMARY OF ESTIMATED RESERVATION TAX POTENTIAL						
Estimated state tax collected from tribal families ($ millions)[f]	$	8.9	0.6	1.6	1.6	2.1
Estimated tax potential of reservation sales, property and income not now taxed ($ millions)	$	216.0	49.8	4.6	21.0	37.9
SOME SELECTED STATE EXPENDITURES ON TRIBAL FAMILIES						
Estimated total AFDC payments to tribal families ($ millions)[g]	$	6.4	2.2	3.3	3.7	1.6
Same, state share[h]	$	2.0	0.7	0.7	1.3	0.7
Estimated total state public education cost for tribal families ($ millions)[i]	$	25.7	5.6	17.2	4.8	14.5
Same, state share[j]	$	9.7	1.5	5.1	1.5	1.0
Estimated state share of tribal families AFDC and education cost ($ millions)	$	11.7	2.2	5.8	2.8	1.7

a. Sources: BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION: SUBJECT REPORT: AMERICAN INDIANS (1973); BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 1975; ECONOMIC DEVELOPMENT ADMINISTRATION, U.S. DEP'T OF COMMERCE, FEDERAL AND STATE INDIAN RESERVATIONS (1974).

b. As used here, "tribal means reservation Indians. Since title census data is available for reservation Indians as such, the figures here are drawn from the census category "Rural Indians," Alternatively, Congress could place subsidization of poor reservations on the same footing as subsidization of poor states, legislatively relieving the states of any legal duty to serve reservation residents while expressly authorizing tribes to apply for direct federal formula funding of all tribal services. This is the better solution. It is far more parsimonious administratively, avoids conflicting concurrent state and tribal administration of reservation services, and strengthens tribal self-determination. In the long run it also might benefit the concerned states, for it would spread the cost of reservation subsidization among all fifty states instead of concentrating it in the states that happen to circumscribe reservations, and it would allow states bordering reservations to enjoy a favorable balance-of-trade without having to pay for reservation services directly.

VI. TRIBAL TAX ADMINISTRATION

Either in the belief that it will improve their ability to challenge state taxation or in response to the rapidly expanding revenue needs of growing populations, tribes are drafting tax codes in unprecedented numbers. It is to be hoped that, in haste, sound policy is not sacrificed. Through careful predraft research and planning, tribes can avoid unpleasant consequences such as unintended business flight, undesirable redistributions of income, diseconomies in administration,

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which is nearly equivalent. Any error will be in the direction of overestimated reservation tax potential and state expenditures.

c. Tribal income potential was computed as follows: tribal income was broken down into $2000 brackets and, with the use of state income tax schedules, the average tax per family in each bracket was calculated and multiplied by the number of tribal families in the bracket. Finally, the total tax payable by each bracket was summed. South Dakota and Washington have no income tax.

d. Very approximate, based on average tax burdens per acre in each state. Since reservation lands are relatively undeveloped, any error should be in the direction of overestimated reservation tax potential.

e. Very approximate, based on the assumption that about 80% of all spending by tribal families is off-reservation. The regressivity of the sales tax was not taken into account for lack of adequate data to make adjustments; any error should be in the direction of underestimating taxes paid or potentially payable.

f. Based on sales taxes alone. No estimate of property taxes paid on-reservation by tribal families on nontrust land was possible.

g. Based on average monthly payments reported by each state and number of tribal families receiving AFDC.

h. Based on federal funding assistance formula.

i. Assumes equal state expenditures on Indian and non-Indian pupils' basic education and excludes all special educational programs and costs for Indian education alone. Most special programs are federally-financed.

j. Estimated from average per-pupil federal assistance through Impact Aid and Johnson-O'Malley programs. Actual formula varies among school districts based on valuation and tax effort. Excludes all federal Indian education funds restricted in 1975 to use in supplemental, as opposed to basic education programs.

and taxpayer rebellion. Consistent sources of revenue, combined with a suitable plan of public services and capital improvement, can improve tribal members' welfare and win the support of resident nonmembers.

A. Planning Tribal Taxes and Other Revenue Sources

The threshold question for tribal officials considering a revenue tax program is whether the tax is necessary. All tribes have revenue needs, but taxation is not the only option they have to meet those needs. Among their alternatives are federal formula assistance, federal discretionary grants, liquidation of tribal assets, and development of profitmaking tribal enterprise. The attractiveness of each alternative depends upon its relative cost. The cost of a funding source includes the expenses of application and administration; risk of nonfunding, lost funding, or, in the case of tribal enterprise, business loss; restrictions on use; accountability; and, where substantial tribal capital and resources are committed, the cost of foregone alternative opportunities.

Any source of revenue also will have a characteristic incidence affecting income distribution. Federal funds, for example, tend to require a large planning and evaluation component and therefore benefit professional employees. Tribal enterprise tends to create new jobs for unskilled and semi-skilled workers. A tax, depending upon its structure, will tend to redistribute income from taxed to nontaxed sectors. If the incidence of a revenue source is undesirable, it must be considered a cost of that revenue. The tribe should prepare for each alternative revenue source a yield projection (for a tax, this is the tax rate multiplied by the taxable base, adjusted for expected tax-related changes in demand); an estimate of the cost of administration, including the anticipated cost of tax delinquency; and an analysis of incidence.

Once a tribe has identified a revenue goal, such as *N* dollars to construct a new community health center, it should rank all alternative sources of *N* dollars in order of cost and choose the mix with the greatest expected net value. If the tribe has a number of independent revenue needs over several fiscal years, it should choose that mix of revenue sources over time that meets all of its needs at the lowest aggregate cost.[192]

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192. "Linear programming" is a widely-used mathematical tool for selecting the optimal mix of public investments and expenditures under given constraints such as maximizing net benefit and keeping total cost below some specified ceiling. Elementary

Since tribes are small their public budgeting process tends to be "lumpy," that is, aggregate expenditures differ greatly from year to year. One year a multi-million dollar community hall is built, then for two years no capital additions are made. Larger government units such as states are so diversified and manage so many different projects simultaneously that their aggregate revenue needs grow at a fairly even pace. Thus, while a state must plan on raising about as much revenue each year, and tends to either hold or advance its tax rates, a tribe may be tempted to allow its tax rates to float with the ebb and flow of its budget. This may be a serious mistake. Individuals and businesses make financial commitments, such as buying a new car or introducing a new product line, on the basis of expected future income. If the tax rate is widely variable, uncertainty as to future income will chill consumption and investments just as surely as a high tax. A better strategy than a "lumpy" tax, then, is to estimate the average future annual needs of the tribe, establish that as the annual revenue goal, and simply reinvest overcollections in slow years for withdrawal and expenditure in busy years.[193]

B. *Some General Considerations in Tribal Taxation*

Tribes are sometimes best thought of as very small underdeveloped countries with special fiscal characteristics quite different from those of the states. One feature of underdevelopment is a low savings rate: people do not accumulate much private surplus capital for reinvestment. As a result, there is really very little to tax; tax revenues, after deduction of the expenses of administration, may be too small to accomplish any significant public purposes.[194] Where most residents have about the same level of income, moreover, there is no point in levying a redistributive (progressive) tax.

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applications of linear programming are explained in J. KEMENY, J. SNELL, & G. THOMPSON, INTRODUCTION TO FINITE MATHEMATICS chs. 6–7 (2d ed. 1966). The definitive application of this tool to problems of finance and expenditure policy is H. WEINGARTNER, MATHEMATICAL PROGRAMMING AND THE ANALYSIS OF CAPITAL BUDGETING PROBLEMS (1963).

193. Tribes are too small to attempt to achieve fiscal stability through tax policy, however. Their economies will always ebb and flow in servitude to state and national growth.

194. Another problem associated with reservation smallness and underdevelopment is a very high net import of foreign (state) goods. When imports are high and income accordingly tends to flow out of the jurisdiction, the multiplier for public expenditures within the jurisdiction is relatively small. Tribes thus suffer both from a small tax base and low effectiveness of expenditures.

Taxing reservation businesses, especially those which are non-Indian or off-reservation owned, might be the easiest and best source of revenue. Taxing only businesses, however, is not necessarily the answer. When tax costs increase, business taxpayers try to shift them to employees and customers. If the tax costs which they are unable to shift exceed their cost of relocation, they move, depriving the jurisdiction of both tax base and employment. Tribal business taxes are therefore to be levied with caution. To a certain extent they will be reflected in lower wages and higher prices on the reservation; this effect will be greatest where tribal labor is unorganized and alternative retail outlets for tribal consumers are remote. The tribe must also know how far it can go before triggering business flight.[195]

Like underdeveloped countries, reservations tend to be best at attracting and holding semi-skilled, labor-intensive assembly industries because of cheap labor, and raw materials or primary products industries such as mining and timber because of abundant, relatively cheap resources and energy. These are industries that can little afford to relocate at present. If resources dwindle, however, or reservation wages approach parity with off-reservation wages, reservations' attractiveness to these industries will weaken, and the industries' taxability will decline. This problem will remain until tribes enjoy higher growth and savings rates and begin to attract more technical and professional jobs.

Another revenue alternative is tribally owned and operated businesses. The use of tribal business enterprise to raise revenue has been widely adopted but not very thoroughly evaluated.[196] Because of their governmental eligibility for federal development assistance programs, tribes often are able to attract development capital at a lower cost than individual reservation entrepreneurs. In many instances,

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195. Businesses are held to a location principally by sunk capital and opportunity costs. Capital is sunk where it cannot be recovered or liquidated; a factory with little resale value or potential for functional conversion is an example. Opportunity costs are the costs of foregoing investment alternatives. The opportunity costs of moving off a reservation include foregoing the lower wages and cheaper raw materials available on reservations.

196. *See generally* STAFF OF AMERICAN INDIAN POLICY REVIEW COMM'N, *supra* note 1. One peculiar disadvantage of tribal enterprise is reduction of the tribe's eligibility for federal revenue-sharing programs based on local tax effort. A tribe that operates a factory and diverts 10% of the gross into public programs does nothing different, really, than one that imposes a 10% gross receipts tax on private business. The latter is counted as tax effort, however, and the former is not. 31 C.F.R. § 51.22(a) (1978). *See also* 31 U.S.C. §§ 1227(a)-(b) (entitlement formula includes local tax effort), 1221(2), 1227(b)(4), 1227(d)(1) (eligibility of tribes for federal revenue sharing) (1976).

tribes already own critical raw materials such as timber, water, and fossil fuels. Finally, tribes are immunized from federal and state taxation, although substantial growth of tax-free tribal economic enterprise probably will stimulate new challenges by federal tax administrators.

A tribal enterprise can adjust its wage scale, payroll, and capital budget to yield any number of mixes of benefits for tribal members. The payroll can be deliberately enlarged, thus increasing mean and median reservation income at the expense of net enterprise revenue. Instead of taking a share of the profits of a private (or public) enterprise through taxation to pay for income supplements, the Indian enterprise simply pays higher wages or employs more people. This eliminates the administrative cost of maintaining a separate government assistance program. On the other hand, it inflates wages and, unless carefully regulated, makes it too costly for private firms relocating on the reservation to attract labor.

However accomplished, the generation of a reliable stream of public revenue is a requirement of tribal government. The challenge of the next decade will be resolution of the jurisdictional uncertainties that render tribal revenue planning virtually impossible.

VII. CONCLUSION

The power to tax is a requirement of government. Its proper scope can never be ascertained by reference to abstractions of law and semantics. Legal formalism in judicial treatment of Indian tax issues has led to economically peculiar results and threatens to deprive tribes of the power of regulation and planning by means of taxation, to impose uncertainty costs, legal risks, and duplicative taxes on reservation taxpayers, and to overcompensate states and the United States beyond their service or expenditure effort. A thorough study of state and tribal tax structures and revenue needs is needed before clarifying legislation can be drafted. In the meantime, it is incumbent on the courts to regard more seriously the real effects of erosion of tribal territorial taxing powers rather than the neatness of rules and distinctions.